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No. 761

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D., 1911

Office Supreme Court, U. S.
FILED.

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JAMES H. McKENNEY,
CLERK.

CITY OF LOUISVILLE,

VS.

CUMBERLAND TELEPHONE AND
TELEGRAPH COMPANY,

Appellant,

Appellee.

Appeal from the Circuit
Court of the United
States for the West-
ern District of Ken-
tucky.

STATEMENT AND BRIEF FOR APPELLANT

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vs.

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COMPANY,

Appellee

Appeal from the Circuit Court of the United States for
the Western District of Kentucky.

PART ONE

BRIEF AND ARGUMENT FOR APPELLANT,
CITY OF LOUISVILLE.

STATEMENT.

May It Please The Court:

The City of Louisville, Kentucky, the appellant in this case, is a city of the first class with authority under the Constitution and laws of Kentucky to govern itself in all

local matters. Among the other powers delegated to it by the Constitution and laws of Kentucky is the power to regulate the rates of public service corporations which occupy its streets.

The appellee, the Telephone Company, operates a telephone exchange in the City of Louisville. With this exchange are connected from nine to ten thousand subscribers in the City of Louisville and three hundred subscribers in Jefferson County outside the City limits.

In January, 1909, the City of Louisville through its Mayor and General Council, conceiving the idea that the appellee was grossly discriminating among its patrons, and charging some of them exorbitant rates and furnishing others free service, or service at ridiculously low rates, enacted an ordinance revoking the right of the appellee to operate a telephone exchange in the City of Louisville.

The purpose of the Mayor and General Council in enacting such an ordinance was to require the appellee to purchase from the City a franchise wherein reasonable rates could be enforced, and whereby appellee could be prevented from discriminating among its patrons.

The ordinance in question appears in the record in case No. 197, October Term 1911, of this Court, *City of Louisville vs. Cumberland Telephone & Telegraph Company*, which case has been ordered to be heard with this cause.

The appellee filed its Bill of Complaint in the United States Circuit Court for the Western District of Kentucky wherein it charged that the above mentioned ordinance was an attempt to violate a contract between it and the City of Louisville, and was in violation of the Constitution of the United States in that it confiscated its property. It sought and obtained a temporary injunction enjoining the

City of Louisville from enforcing the provisions of that ordinance.

As the Mayor and General Council of the City of Louisville were thereby prevented from accomplishing their purpose, they proceeded to enact an ordinance whereby they sought to regulate the rates to be charged by the appellee in the City of Louisville. That ordinance is printed in this record (see p. 12), and is as follows:

"An ordinance fixing the maximum rates to be charged for telephone service in the City of Louisville.

"Be it ordained by the General Council of the City of Louisville:

"Section 1. That no company, corporation or individual operating, conducting, maintaining a telephone system, or furnishing telephone service in the City of Louisville, shall charge more for such service than the following rates which are hereby fixed, established and ordained to be the maximum rates that may be charged for telephone service in the City of Louisville.

"Section 2. For each telephone in a business house or office the maximum rates of charge shall not exceed,

"For a single or private line, unlimited service, \$5.50 per month, or at the rate of \$66.00 per year.

"For a party line, unlimited service, \$4.00 per month, or at the rate of \$48.00 per year.

"For each telephone in a residence the maximum rate or charge shall not exceed:

"For a single or private line, unlimited service, \$3.00 per month, or at the rate of \$36.00 per year.

"For a party line, unlimited service, \$2.00 per month, or at the rate of \$24.00 per year.

"For each extension desk telephone the maximum rate or charge shall not exceed \$1.00 per month, or at the rate of \$12.00 per year.

"Section 3. Any person, firm or corporation violating any provision of this ordinance, or charging a higher rate for telephone service than is fixed by this

ordinance, shall be subject to a fine of not less than \$5.00 nor more than \$25.00 for each offense. Each charge for telephone service in excess of the rates herein fixed, and each month that such charge is made for such service, shall constitute a separate offense.

"Section 4. That an ordinance entitled 'An Ordinance regulating the charges for telephone service in the City of Louisville,' approved November 12, 1906, is hereby repealed: provided, however, that this ordinance shall not be so construed as to confer upon any person, firm or corporation now conducting or operating a telephone system in the City of Louisville the right to charge any rate in excess of that limited in the charter or franchise of such person, firm or corporation.

"Section 5. This ordinance shall take effect from and after its passage."

Thereafter the appellee filed its Bill of Complaint in the above entitled cause wherein it charged that the ordinance rates, if enforced, would result in preventing it from earning a reasonable return on the value of its property and would confiscate its property, in violation of the Fourteenth Amendment to the Constitution of the United States.

The lower Court granted a restraining order wherein the City and all other persons were restrained from seeking to enforce the provisions of the rate ordinance in question until the further order of the Court.

A motion for a temporary injunction was made within ten days after the filing of the Bill and fully argued, numerous affidavits having been filed by appellant and appellee on the hearing of that motion. The lower Court, however, failed to grant the temporary injunction, but allowed the restraining order to remain in force for more than two years and until the final hearing of the cause.

THE CITY'S ANSWER.

In its answer the City denied that the rates fixed by it in the ordinance were unreasonable and denied that the enforcement of those rates would result in the confiscation of appellee's property.

It charged (Record, p. 40) that the appellee had, prior to the passage of the ordinance, conducted its business in a dictatorial, arbitrary and offensive manner and without regard to the rights of the citizens of Louisville; that the appellee was discriminating unmercifully among its patrons, even going to the extent of furnishing free telephones in order to stifle competition; that the ordinance was passed primarily to prevent appellee from charging exorbitant rates to some of the citizens of Louisville, and further as a means of preventing appellee from continuing to discriminate among its patrons.

And appellant prayed that the bill be dismissed and that it recover its costs.

MASTER APPOINTED.

A Special Master was appointed to make an investigation of the affairs of appellee and report his findings to the Court (see Record, p. 54).

The Master permitted the City to select an accountant and appellee to select an accountant, and these two accountants were directed to examine the books and records of appellee and make a joint report to the Master of their findings. These accountants did examine the books and did make a joint report and also separate reports (see Record, p. 102).

A large amount of evidence was taken by both appellant and appellee. The case was finally argued before the Master and his report was made to the Court in accordance with the order of reference (see Record, p. 59).

By the terms of that report the Master found that the appellee was, under the rates charged prior to the passage of the ordinance, earning more than 11 per cent on the value of its property (Record, p. 85) and that after paying all expenses, including a provision for depreciation, the appellee could, the first year after the rate ordinance was put into effect, earn 8 per cent on the value of its plant and could within two years thereafter earn 11 per cent on the value of its plant. (Record, p. 88.)

The Master's recommendation was that the validity of the ordinance in question be upheld and that the injunction asked by the appellee be denied.

The lower Court, however, overruled the findings of the Master in every instance, entered a decree declaring the ordinance in question void in that the rates were so low as to confiscate the appellee's property, and perpetually enjoined the City from attempting to put the rates into effect.

From that decree this appeal is prosecuted to this Court.

The Bill of Complaint filed in the above styled action is copied in the record in No. 197, October Term, 1911, *City of Louisville vs. Cumberland Telephone & Telegraph Company*, and by stipulation is ordered read as part of this record.

PART TWO

SPECIFICATIONS OF ERRORS RELIED UPON.

The following are the Specifications of Errors on which appellant bases this appeal. (Record, p. 1645.) See Note.

1. The Court erred in holding and finding that "the ordinance adopted by the City of Louisville on February 27, 1909, through its legislative department and approved by the Mayor on March 6, 1909, being an ordinance entitled 'An ordinance fixing the maximum rates to be charged for telephone service in the City of Louisville,' is as to the complainant confiscatory, null and void, and violates the Fourteenth Amendment to the Constitution of the United States in that it would if enforced deprive the complainant of its property without due process of law."

2. The Court erred in failing and refusing to hold that the rates fixed by the ordinance of February 27, 1909, were fair and reasonable; and in refusing to hold that said ordinance was valid as to complainant and not confiscatory, null or void.

3. The Court erred in decreeing and granting unto the complainant an injunction perpetually enjoining the City

NOTE. Should this brief embody verbatim the exceptions filed by the appellee to the Master's report, most of which exceptions were sustained, it would be unduly voluminous. Those exceptions are copied in the Record on pages 105 to 198 inclusive. The exceptions as drawn constitute in reality appellee's brief in this case. A reproduction of these exceptions instead of assisting the Court would merely result in confusion. I have, therefore, stated as concisely as possible the errors on which appellant relies for a reversal, referring wherever possible to the pages on which appellee's exceptions may be found.

of Louisville, its officers, agents and employes and all other persons from undertaking to enforce in any wise the provisions of the ordinance referred to in said decree.

4. The Court erred in decreeing and adjudging unto the complainant a recovery against this defendant of the costs of this cause including compensation allowed by the Court to the Special Master.

5. The Court erred in finding that the defendant enacted the ordinance referred to in the decree without making any adequate inquiry into the real facts upon which such action could intelligently be based.

6. The Court erred in overruling the motion of the defendant for an order permitting it to examine the books and records of the complainant company touching the value of the plant and the earnings and expenses of the company in the City of Louisville for the years 1905, 1906, 1907 and 1908.

7. The Court erred in failing and refusing to hold that the complainant was not entitled to the decree sought for the reason that complainant had failed and refused to make a frank, free and full disclosure of its books, records and accounts, and deprived the defendant and defendant's accountants of access to its books and records whereby the defendant might ascertain what amount had been expended by the complainant in constructing and operating its said plant in Louisville, Kentucky.

8. The Court erred in that it failed and refused to dismiss the Bill of Complaint because the complainant refused to make a full, free and frank disclosure of its books and records and refused through its officers, who testified in the case, to answer questions and disclose facts and records concerning the cost of said plant and the ex-

penses of operating said plant over the period investigated by the Master.

9. The Court erred in failing and refusing to dismiss complainant's bill because the complainant was and is grossly discriminating among its patrons in the City of Louisville.

COST OF PLANT.

10. The Court erred in failing and refusing to find that the complainant so concealed the facts and so manipulated its books that it was impossible to tell from its said books and records what its plant in the City of Louisville had cost.

11. The Court erred in finding that the complainant's plant had cost in excess of \$1,745,235.00; the complainant itself only charging in its bill and producing evidence to show that its plant had cost \$1,700,000.00; and the Master having found that the complainant's plant cost \$1,381,124.41.

12. The Court erred in sustaining exceptions to the Master's report wherein the Master found that complainant's plant in the City of Louisville had cost it \$1,381,124.41. (Record Exceptions, pp. 105 to 123.)

VALUE OF PLANT.

13. The Court erred in failing and refusing to ascertain "the present value of the company's property" by following "the plain method of ascertaining the cost of reproduction diminished by depreciation." (212 U. S. 14).

14. The Court erred in finding that "the Master seems to have based his final estimate of the value of the plant largely upon his conclusion as to its original cost, less

certain depreciation, and then he makes a flat deduction therefrom of 10 per cent in addition." The fact being that the Master found from the evidence that it would cost so much money to reproduce the plant new throughout and then found that the plant was 10 per cent less valuable than if new throughout.

15. The Court erred in finding that the valuation placed by the Master on the plant was too low.

16. The Court erred in finding that the 10 per cent deduction in the value of the plant as found by the Master "was in a large measure an arbitrary deduction in the sense that it was without an adequate basis in view of the large expenditures made to keep the plant up to the standard." The fact being that said 10 per cent deduction was based on the evidence and sustained by all the facts in the case.

17. The Court erred in finding that the complainant was entitled to earn a dividend on \$1,788,000.00, which the Court found to be the value of complainant's plant; complainant having charged in its Bill of Complaint that it was only entitled to earn a dividend on \$1,700,000.00 representing the value of its plant; and the Master having found that complainant was under the evidence entitled to earn a dividend on only \$1,243,011.97 representing the value of the plant, less depreciation.

18. The Court erred in finding that the value of the plant "including toll lines and excluding the things presently mentioned is and was when this suit was brought at least \$1,575,000.00; that the real estate is worth \$162,000.00; that the supplies on hand are worth \$18,000.00; and that the working capital should be placed at \$33,-

000.00; making a total value of the company's property now being used by the public \$1,788,000.00."

19. The Court erred in sustaining exceptions to the Master's report wherein the Master found the value of the plant, exclusive of toll lines and real estate, to be as of March 6, 1909, \$1,243,011.97. (Record Exceptions, p. 124.)

20. The Court erred in including in the value of the plant the value of the real estate, it appearing from the record that the complainant does not treat its real estate as a part of its plant, but charges a rental of \$13,800.00 against the Louisville exchange as operating expenses, which amount is more than 8 per cent on the value of the real estate.

21. The Court erred in finding the value of the real estate of the complainant to be \$162,000.00.

22. The Court erred in including as part of the value of complainant's plant supplies on hand amounting to \$18,000.00, and working capital amounting to \$33,000.00; it appearing from the record that the supplies on hand are kept in complainant's supply department, the expenses of maintaining which are charged against the Louisville exchange at 10 per cent on the cost price of all supplies charged against the Louisville exchange whenever any supplies are furnished from said supply department to the Louisville exchange; and as to the working capital it appearing from the record that the rentals are paid in advance and that no working capital is required.

23. The Court erred in sustaining exceptions to the Master's report wherein the Master excluded from the value of the plant supplies on hand and working capital. (Record, 140.)

24. The Court erred in finding that no amount was included by the Master in the valuation of the plant as found by him representing the value of the franchise, whereas the amount found by the Master as the value of said plant, namely, \$1,243,011.97, included the amount paid by the complainant for said franchise.

25. The Court erred in finding that the value of the toll lines should be included as part of the value of the Louisville exchange, and in finding that "all agree that the toll lines should have been included" in the value of the exchange; and in refusing to eliminate the value of the toll lines from the value of the exchange.

26. The Court erred in fixing any value on the toll lines, there being no evidence whatever to show the value of said toll lines and there being no evidence whatever to show what it would cost to reproduce the said toll lines.

27. The Court erred in including in its valuation of the plant the value of certain dead cable, that is, cable not being used and which was in no wise a part of the exchange plant.

28. The Court erred in including in the valuation of the plant items representing cost of supervising the building of the plant, it appearing that all such cost had been paid out of the earnings of the plant. (Record Exceptions, 124 to 141.)

EXPENSES.

29. The Court erred in including as part of the complainant's expenses for 1908 the sum of \$13,800.00, or any amount, as rental on the real estate owned by the complainant, which amount was more than 8 per cent on the book value of said real estate; the Court having found

that the complainant was entitled to earn a dividend of 7 per cent on the book value of said real estate, the result of which was to allow the complainant to earn more than 15 per cent on the value of its real estate in Louisville, Kentucky.

30. The Court erred in including as part of the expenses of conducting complainant's exchange for 1908, the sum of \$31,910.00, which amount was expended by the complainant in conducting its long distance business in the City of Louisville; the evidence showing that 15 per cent of the total receipts of the complainant at Louisville was derived from the long distance business and that at least 15 per cent of the expenses of the complainant at Louisville were properly chargeable against the long distance department of its business; the record showing that salaries were paid to long distance operators alone exceeding \$11,000.00 per year and that this \$11,000.00 expenditure did not include any of the general expenses of the company, any expense of maintenance, rent, light, heat, taxes or insurance.

34. The Court erred in allowing for depreciation and as a part of the expenses of complainant 7 per cent on \$1,575,000.00, a sum said to represent the value of a portion of complainant's plant, or a total for depreciation of \$110,250.00.

35. The Court erred in failing and refusing to find that \$92,606.83 was the amount which complainant should have been allowed to set aside for the year 1908 to provide for maintenance, repairs and depreciation; and the Court erred in sustaining exceptions to the Master's report wherein the Master found such to be the fact. (Record, p. 154.)

36. The Court erred in failing and refusing to find that 7 per cent on the value of complainant's plant was a sufficient sum to be allowed in the future each year as a part of the expenses of the plant to take care of maintenance, repairs and depreciation; and the Court erred in sustaining exceptions to the Master's report wherein the Master found such to be the fact. (Record, p. 154.)

37. The Court erred in failing and refusing to find that the experience of the complainant in operating a telephone plant in the City of Louisville for a period of nine years, and the experience of the complainant's predecessor for a period of ten years prior thereto justified the Court in finding that 7 per cent on the value of complainant's plant was all that had been required to take care of maintenance and repairs and provide a fund for depreciation; and the Court erred in sustaining exceptions to the Master's report wherein the Master found such to be the fact. (Record Exceptions, p. 141 to 167.)

EARNINGS.

38. The Court erred in finding the gross earnings for the year 1908 to be \$330,926.38 instead of \$369,087.00, as found by the Master.

39. The Court erred in excluding from the earnings of the complainant all the receipts of the Louisville exchange on outgoing messages over its long-distance lines, and in sustaining exceptions to the Master's report wherein the Master allowed such receipts as part of the earnings of the Louisville exchange. (Record, p. 146.)

40. The Court erred in only allowing \$12,632.11 to the Louisville exchange as its portion of the earnings from long-distance business of the complainant for the year

1908 and in sustaining exceptions to the Master's report wherein the Master allowed \$50,880.81 as the portion of the earnings of the long-distance business which should be credited to the Louisville exchange. (Record, p. 146.)

41. The Court erred in finding that 15 per cent of the toll earnings on outgoing messages over complainant's lines was "a fair compensation for the service" rendered by the Louisville exchange to the long-distance department of the complainant.

45. The Court erred in failing and refusing to find that the net earnings under the rate ordinance for future years, if all subscribers were charged alike and according to the class of service each subscriber had, no discrimination being practiced among subscribers, would probably amount to \$30,000.00 in excess of what the net earnings were found to be under the rates in effect during the year 1908.

46. The Court erred in finding that the rates of the complainant were lowered 30 per cent by the rate ordinance.

47. The Court erred in failing and refusing to find that the gross exchange earnings alone (excluding toll earnings) for the year 1908, had the rate ordinance been in effect and no discrimination practiced, would have been \$327,283.42.

48. The Court erred in finding that the net earnings "may be lowered to some extent by the new Federal taxation, and the cost and expenses of this action," there being no evidence in the case touching on this subject.

49. The Court erred in finding that any earnings less than 7 per cent on the value of complainant's plant was confiscatory.

50. The Court erred in finding that the net earnings for the year 1908 were only \$114,563.07, and in sustaining exceptions to the Master's report wherein the Master found that the net earnings for said year were \$150,673.19. (Record, 159.)

51. The Court erred in finding that the net earnings for the year 1908 were only \$90,468.29 if certain findings were correct.

52. The Court erred in finding that the net earnings for the year 1908 were only \$96,262.11 if certain findings were correct.

53. The Court erred in failing and refusing to hold that had the rate ordinance been in effect during the year 1908, the complainant would have earned in excess of 7 per cent on the value of its plant after paying all operating expenses and providing a sufficient sum for depreciation.

54. The Court erred in finding "that complainant company is entitled to be allowed to earn if it can as much as 7 per cent annually on the fair value of its property devoted to the public use in this city before its rates can fairly be reduced by legislative regulation."

55. The Court erred in finding that complainant was entitled to earn 7 per cent on \$1,788,000.00, which sum the Court found to be the value of complainant's plant.

56. The Court erred in sustaining exceptions to the Master's report wherein the Master found that "the average net income or return from reasonably safe investments in business enterprises in Louisville approximately resembling that of the complainant, is below 6 per cent upon the reasonable value of the plant or property from which said income is derived." (Record, 184.)

57. The Court erred in finding that complainant was entitled to earn 7 per cent on the value of its real estate in Louisville, it appearing that said real estate is treated by the complainant as an outside investment, and a rental of over 8 per cent on the value of said real estate is charged up each year against the Louisville exchange as a part of the operating expenses of said Louisville exchange.

58. The Court erred in finding that complainant "does not under the present rates and after an allowance of 7 per cent for depreciation on the portion of the property subject thereto, earn over 5 10-17 per cent upon the value of that property."

58a. The Court erred in sustaining exceptions to that portion of the Master's report, wherein the Master found that "the per centage of net earnings to the value of complainant's plant for the four years was as follows: 1908, 11.14 per cent." (Record, 165.)

59. The Court erred in finding that "judging by the year 1908 and allowing 7 per cent for depreciation that the net profits of the company on the value of its property under the rate ordinance would be \$60,468.00, or only 3 6-17 per cent annually for the present."

MISCELLANEOUS.

60. The Court erred in failing and refusing to hold that the complainant's bill should be dismissed and the injunction sought by it denied, because the evidence showed that sums earned by the complainant in operating its Louisville plant and set aside for depreciation had been used by it in extending and making additions to its said plant, and had become an integral part of the plant on which it was

seeking to earn dividends; and failed to show how much of said earnings had been so invested.

61. The Court erred in failing and refusing to dismiss complainant's bill and in failing and refusing to deny the injunction sought by the complainant because the evidence showed that some of the money earned by the complainant on its Louisville plant had been used by it in making extensions and additions to said Louisville plant and which sums had become an integral part of the said Louisville plant and the capital account on which the complainant was seeking to earn dividends; but did not show how much of said earnings had been so invested.

62. The Court erred in refusing to dismiss the complainant's bill for the reason that the complainant had no franchise to occupy the streets of the City of Louisville; was a wrongdoer; was without right to operate a telephone system in the City of Louisville and, therefore, should not have been permitted to question the rates established by the rate-making body of the City of Louisville.

63. The Court erred in finding that the probable increase in the subscribers in the future was doubtful; it appearing in the record that the company had lost over 2,000 subscribers by having raised its rates, and all witnesses agreeing that a reduction of the rates would materially increase the number of subscribers.

64. The Court erred in failing and refusing to find that an increase in the number of its subscribers would be remunerative to the company; that the complainant had surplus system to take care of more than 2,000 new subscribers, and in sustaining exceptions to the Master's report wherein the Master found such to be the fact. (Record, 167.)

65. The Court erred in failing and refusing to find that an increase in the number of subscribers would not increase the cost of operating the telephone plant per station; and in sustaining exceptions to the Master's report wherein the Master found such to be the fact. (Record, 167.)

66. The Court erred in finding that there were more hazards connected with the complainant's business than with the business of other public utilities such as gas companies, railway companies and electric lighting companies.

67. The Court erred in granting the injunction before a fair trial had been made of continuing the business and conducting the business under the rates established by the rate ordinance.

68. The Court erred in granting a temporary restraining order enjoining the enforcement of said ordinance pending the litigation involving the validity of said ordinance.

69. The Court erred in refusing to dissolve said temporary restraining order on motion of the defendant, which refusal was made by an order entered in the case on the 29th day of June, 1909.

70. The Court erred in refusing to grant the motion of the defendant to require the complainant to impound and pay into Court or give bond for the return of the amounts collected by it for telephone service in excess of the rates fixed by the rate ordinance.

71. The Court erred in refusing and failing to give any weight to "the rates in force in numerous cities where the circumstances are as nearly similar as may be to those prevailing" at Louisville. (115 Fed. Rep. 741.)

72. The Court erred in sustaining exceptions to the depositions of S. M. Wilhite and Charles Meriwether, said witnesses having testified in effect as follows:

That they were officials and accountants of the City of Louisville; that under instructions from the Mayor of the City of Louisville and at the request and with the consent of the Louisville Home Telephone Company, which telephone company operates a telephone exchange in the City of Louisville, said witnesses examined the books and records of the said Telephone Company and ascertained that the gross earnings of said company for the year 1907 were \$382,104.47; that the expenses of every nature for operating and maintaining said plant for the year 1907 were \$204,646.53; and that the net earnings for said year 1907 were, therefore, \$177,457.94;

That for four months of the year 1908 the gross income of said Louisville Home Telephone Company was \$134,035.18 and the expenses were \$63,359.96;

That the following figures represent the net earnings of the Louisville Home Telephone Company for the years mentioned after all expenses *and interest on the bonded indebtedness* had been paid:

1903	\$69,326.76
1904	75,988.77
1905	96,487.60
1906	102,237.24

(The pertinency of all which testimony is in its bearing upon other testimony in the case, wherein it was shown that the rates of the Louisville Home Telephone Company were 50 per cent lower than the rates charged by the complainant at the time the rate ordinance was passed; wherein it was shown what it had cost the Louisville Home Tele

phone Company to build its plant; and that on rates 50 per cent lower than those charged by the complainant the Louisville Home Telephone Company was earning over 12 per cent on the value of its plant.)

And the Court erred in failing and refusing to sustain exceptions to that portion of the Master's report wherein the Master reported that he had quashed the foregoing depositions of S. W. Wilhite and Charles Meriwether.

And further erred in refusing to consider the said depositions as evidence in the case.

70. The Court erred in refusing to require the witness, C. E. Archer, to testify in the case; that said Archer, had he been permitted and required to testify, would have stated (and it is true) that he was treasurer of the Louisville Home Telephone Company; that the gross earnings of the said Telephone Company for the year 1907 were \$382,104.47; that the expenses for said year were \$204,646.53; that the net earnings for the following years after *all interest on the bonded indebtedness* had been paid were as follows:

1903	\$69,326.76
1904	75,988.77
1905	96,487.60
1906	102,237.24

that the plant of the Louisville Home Telephone Company had not cost in excess of \$1,300,000.00; that the company had 11,000 telephone subscribers in the City of Louisville where it conducted a telephone exchange; and that the company for the years 1905, 1906, 1907 and 1908 had earned in excess of 12 per cent on the value of its plant after paying all expenses and providing a fund for depreciation.

And the Court erred in sustaining exceptions to that portion of the Master's report wherein the Master reported that he had not required the said witness to testify and had quashed the said deposition.

As to appellant's exceptions to the Master's report:

1. The Court erred in overruling the exceptions filed by the City of Louisville to that portion of the report of the Master wherein the Master suppressed the depositions of William Kavanaugh, Charles Meriwether and S. M. Wilhite, which exceptions to the Master's report are as follows (Record, p. 198) :

"That the Master, in the trial of the cause on the motion of the complainant, and over the objections and exceptions of this defendant, suppressed the depositions of William Kavanaugh, Charles Meriwether and S. M. Wilhite and held the testimony of said witnesses irrelevant and incompetent; when in fact the Master should have overruled the motion of the complainant to suppress said depositions and should have considered said depositions on the hearing of this cause; said witness Kavanaugh having testified to the value and the cost of constructing the telephone plant of the Kansas City Home Telephone Company and the earnings and expenses of said company, the dividends paid by said company, and the rates charged by said company, all of which facts were pertinent and relevant on the trial of this cause; and said Charles Meriwether and S. M. Wilhite having testified as to the earnings and expenses of the Louisville Home Telephone Company, a telephone company doing business in the City of Louisville, Kentucky, which facts were pertinent and relevant on the trial of this cause. (See Supplemental Report of Master filed December 10, 1910.)"

2. The Court erred in overruling the exceptions filed by the City of Louisville to that portion of the report of the Master wherein the Master refused to eliminate from the

expenses of conducting appellee's plant \$9,722.52 representing excess instrument rental for the year 1908, and similar items for the years 1905, 1906 and 1907, said exceptions to the Master's report being as follows (Record, p. 199) :

"That the Master in his said report stated and certified that the complainant was entitled to charge as a part of its operating expenses for operating its plant in the City of Louisville an item denominated 'instrument expense,' amounting to the following sums for each of the following years:

1905	\$11,559.76
1906	12,518.70
1907	13,372.49
1908	13,722.52

whereas the Master ought to have found that the complainant was only entitled to charge as part of its operating expense the following sums for each of said years representing said instrument expense, to-wit:

1905	\$4,000.00
1906	4,000.00
1907	4,000.00
1908	4,000.00

it having been shown in the deposition of W. H. Crumb (page 60) and the deposition of W. C. Polk (page 111) and the deposition of H. Blair Smith (pages 324 and 511) that about ten thousand of these instruments are used by the complainant in its Louisville exchange; that said instruments last about eight years; that they cost about \$2.00 per instrument; and that said instruments, or instruments equally as good or better, can be purchased in the open market; and, therefore, the complainant was permitted to charge and was allowed as part of its operating expenses for instrument expense about 65 per cent on the value of the instruments, whereas it should not be permitted to charge nor allowed over 20 per cent thereon."

3. The Court erred in overruling the exceptions filed by the City of Louisville to that portion of the report of

the Master wherein the Master refused to eliminate from the items of expense \$802.94 representing excess taxes on buildings and real estate for the year 1908 and similar items for the years 1905, 1906 and 1907, the exceptions to said report in this respect being as follows (Record, p. 199) :

"The Master in said report stated and certified on page 43 of his report that the amounts expended by the complainant in connection with the general expense account for operating its telephone system in the City of Louisville were as follows :

\$28,152.52 for the year 1905;
 \$34,888.46 for the year 1906;
 \$33,749.19 for the year 1907;
 \$31,513.00 for the year 1908,

whereas the Master ought to have found the amounts expended under the head of general expense account in operating complainant's telephone system in the City of Louisville were as follows :

\$27,319.78 for the year 1905;
 \$34,078.84 for the year 1906;
 \$32,911.33 for the year 1907;
 \$30,710.06 for the year 1908.

the difference being made up of the following items, to-wit :

\$832.74 for the year 1905;
 \$809.62 for the year 1906;
 \$837.86 for the year 1907;
 \$802.94 for the year 1908,

which last named items represent the taxes paid by the complainant on its exchange building and real estate in the City of Louisville, other than on its main exchange. The Master having reported on pages 35, 36, 37 and 42 that the complainant treats the real estate which it owns in the City of Louisville as an outside operation and charges against the earnings of the Louisville exchange rent of over 8 per cent on the said real estate, and charges against the Louisville exchange taxes on said real estate and buildings; and that if the taxes were paid by the complainant out of

said rent, and not charged against the Louisville exchange, then the complainant would receive over 6 per cent income on the value of its real estate and buildings, which percentage the Master finds to be in excess of what owners of similar real estate usually derive from the use of similar property in the City of Louisville. (See also the deposition of H. B. Warren, pages 491 to 498 and 534 to 536, together with Exhibit No. 8 filed with H. B. Warren's deposition.)

4. The Court erred in overruling the exceptions filed by the City of Louisville to that portion of the report of the Master wherein the Master refused to eliminate from the items of expense \$1,308.30 representing insurance on the buildings of the appellee for the year 1908, and similar items for the years 1905, 1906 and 1907, said exceptions to the report on account of this item being as follows (Record, p. 200) :

"That the Master has in said report stated and certified that the amounts expended by complainant in the way of maintenance and charged up as a part of the expense of operating its telephone plant in the City of Louisville were as follows :

1905	\$49,819.14
1906	52,796.93
1907	65,616.31
1908	54,705.91

whereas the Master ought to have found that the amounts expended by the complainant in the way of maintenance, and the amounts complainant was entitled to as a part of the expenses of operating its telephone plant in the City of Louisville were as follows :

1905	\$48,674.49
1906	51,475.63
1907	64,408.96
1908	53,397.61

the difference being the following items :

1905	\$1,144.65
1906	1,321.30
1907	1,207.35
1908	1,308.30

which last mentioned items represent the insurance paid by the complainant on its buildings in the City of Louisville and charged up as a part of the operating expenses of the Louisville exchange; the Master having found in his third finding of fact (pages 35, 36, 37 and 42) that the complainant treats its buildings in the City of Louisville as an outside operation and charges against the Louisville exchange a rental equal to 8 per cent of the value of said real estate, and also charges against the Louisville exchange as expense the insurance which it pays on its said buildings; whereas, the said complainant is only entitled to charge against the Louisville exchange the rent which it does charge and should be required to pay out of its said rent the insurance on said buildings. (See also H. B. Warren's deposition, pages 491 to 498 and 534 to 536, and also Exhibit No. 8 filed by said H. B. Warren with his deposition.)"

5. The Court erred in overruling the exceptions filed by the City of Louisville to that portion of the report of the Master wherein the Master refused to eliminate from the expenses the sum of \$9,900.00 representing what the earning would have been on free telephones furnished by appellee to its patrons in the City of Louisville, said exceptions being as follows (Record, p. 201) :

"That the Master has in said report stated and certified that the total amounts expended by the complainant in operating its plant in the City of Louisville were as follows :

1905	\$226,052.32
1906	232,838.37
1907	245,520.89
1908	216,363.07

whereas the Master ought to have found that the total amounts expended by the said complainant in operat-

ing its said plant in the City of Louisville were as follows:

1905	\$206,615.17
1906	212,288.75
1907	224,203.29
1908	194,559.31

the difference being made up of the items specifically referred to and excepted to in the second, third and fourth exceptions hereof, which are as follows:

Excess

instrument.	Expense.	Taxes.	Insurance.	Total.
1905	\$7,550.76	\$832.74	\$1,144.65	\$9,537.15
1906	8,518.70	809.62	1,321.30	10,649.62
1907	9,372.49	837.86	1,207.35	11,417.70
1908	9,772.52	802.94	1,308.30	11,883.76

and also the following items:

For each of the years 1905, 1906, 1907 and 1908, the amounts charged up against the Louisville exchange as part of the operating expenses of said exchange, as shown by Mr. Warren's deposition (pages 523, 524 and 525), included the sum representing what the earnings would have been on telephones furnished by the complainant to its patrons in the City of Louisville free of charge had those patrons paid the regular rates for such services. This item, according to Exhibit No. 6 filed with the deposition of H. Blair Smith, auditor of the complainant, amounts for each of the years in question as follows:

1905, 1906, 1907 and 1908 . . . \$9,900.00

"The finding of fact on the subject of total amount expended by the complainant in operating its plant in the City of Louisville, therefore, should have been the amount represented by the difference between the amounts found by the Master on page 47 of his report as the total operating expenses, and the items mentioned in exceptions, second, third and fourth hereof, plus \$9,900.00, above referred to, which difference represents the total expenses incurred by the complainant

in operating its plant in the City of Louisville, and for the respective years in question is as follows:

1905	\$206,615.17
1906	212,288.75
1907	224,203.29
1908	194,559.31

6. The Court erred in overruling the exceptions filed by the City of Louisville to that portion of the report of the Master wherein the Master found that had the ordinance rates been in effect in 1908, then the amount received by appellee during that year would have been \$49,721.36 less than the amount actually received by the appellee under existing rates, the exceptions to the Master's report in this respect being as follows (Record, p. 202):

"That the Master has in said report stated and certified that had the ordinance rates been in effect in 1908, then the amount received by the complainant during the year 1908 would have been \$49,721.36 less than the amount actually received by the complainant; whereas, the Master ought to have found that the complainant would have earned and received during the year 1908, had the rates fixed by the ordinance of March 6, 1909, been in force, and had all the subscribers to complainant's telephone service been charged at the rates fixed by the ordinance, \$5,793.00 in excess of what complainant did earn and receive under the rates which it charged to subscribers during the year 1908. H. B. Warren in his deposition (page 559), showing that the accountants reached the said figures (\$49,721.36) by making a calculation based on what each subscriber to the complainant's telephone service would have been required to pay had the ordinance rates been in force, eliminating from such calculation all subscribers to the complainant's telephone service who were charged less than the ordinance rates. For instance, where a telephone subscriber had a direct business telephone line and was, during the year 1908, required to pay only \$4.00

per month, the accountants in said calculation did not take into consideration the fact that under the ordinance rates such subscriber could be and should be required to pay \$5.50 per month. The said \$49,721.36 was, therefore, arrived at on a false basis and on an erroneous calculation."

7. The Court erred in overruling the exceptions filed by the City of Louisville to that portion of the report of the Master wherein the Master found that should the ordinance rates be in force during the year 1911 the earnings would probably amount to \$30,000.00 below what the net earnings were under the rates during the year 1908, the exceptions to the Master's report in this respect being as follows (Record, p. 202):

"That the Master in said report stated and certified that the complainant's net earnings, should the ordinance rates be in force during the year 1911, would probably amount to \$30,000.00 below what the net earnings were under the rates charged in 1908; whereas the Master ought to have found that the said net earnings for the year 1911 under the ordinance rates would probably amount to \$30,000.00 in excess of what the net earnings were found to be under the rates in effect during the year 1908. (See Warren's deposition, pages 539 to 552, inclusive, and also Exhibits 14, 15, 15a and 16, filed by said Warren with his deposition, and also Exhibit No. 6 filed by H. Blair Smith with his deposition.")

PART THREE

ARGUMENT.

From a reading of the books I have been unable to find a single case wherein a Court after appointing a Special Master to investigate the facts touching the confiscatory nature of a legislative rate, failed to sustain the Master where he reported in favor of the validity of the rate.

In view of the fact that the opinion of the lower Court, is based on theories and assumptions which were not even advanced by the appellee and which are not sustained by any evidence, the following facts are pertinent:

The Bill of Complaint was filed on the 8th day of March, 1909. On the same date a restraining order was issued. (Record, p. 26.) On the 31st day of March a motion for a temporary injunction was made and argued. Numerous affidavits were filed and two days were consumed in the hearing of the motion. (Record, p. 52.) The lower Court took under consideration the motion for a temporary injunction. No action having been taken by the Court on this motion the appellant moved the Court on the 15th day of June, 1909, for an order dissolving the restraining order (Record, p. 56). The Court took this motion under submission and subsequently on the 29th day of June, 1909, overruled it.

On the 30th day of June, 1909, the City moved the Court for an order requiring the appellee to impound all rentals collected by it in excess of the rentals permitted

under the rate ordinance (see Record, p. 57). The Court took this motion under submission, but failed to pass on it at all, and allowed the restraining order to remain in force from the 8th day of March, 1909, until the final decree was entered on the 25th day of April, 1911, under which final decree the restraining order was converted into a perpetual injunction.

Appellant assigned this conduct on the part of the lower Court as an error (see Record, p. 1653) for the reason that the only practical relief which litigants and their counsel have from the action of a trial Court in granting a restraining order and allowing it to remain in force indefinitely, is for this Court to place its stamp of disapproval thereon.

It is idle to say that the Circuit Court of Appeals, or this Court, could be applied to for a writ of mandamus to compel the trial Court to pass on the motion for a temporary injunction. Every litigant and every counsel engaged in a cause expects a favorable decision, and knowing well that if he applies to an Appellate Court for a mandamus to compel a trial Court to perform its duty it will prejudice his case in the lower Court, refrains from adopting any such course.

This case was pending before the Master for almost two years. Had the lower Court passed on the motion for a temporary injunction and granted it, then appellant could have applied to the Circuit Court of Appeals with every reason to believe that the temporary injunction would have been dissolved and the rates put into effect. Had those rates gone into effect the Master and the lower Court would have had before them the practical operation

of those rates for at least one year before even the Master made his report.

At the outset I propose to discuss the opinion of the lower Court and to show that if there be eliminated from it certain erroneous findings of fact—findings of fact which are sustained by no evidence whatever and which not even the appellee contended for—then under the opinion itself the rates will be shown to be reasonable and not confiscatory.

VALUE OF THE PLANT AS FOUND BY THE LOWER COURT.

The appellee charged in its Bill of Complaint (Record, p. 45) that its property used in the City of Louisville in the conduct of its business was of the value of \$1,700,000.00.

Three telephone engineers, viz., W. C. Polk, W. H. Crumb and S. D. Levings, inspected and placed a value on the appellee's plant.

The appellee's superintendent of construction, J. E. Jagoe, inspected the plant and placed a value thereon.

There is in the record a report of D. C. Jackson, of Boston, Mass., to the Massachusetts Highway Commission showing the valuation placed by him on the Bell Telephone plant in Boston, Mass.

There is also in the record a report made by three telephone engineers to the City of Chicago wherein they placed a valuation on the Bell Telephone plant in the City of Chicago.

From these two reports it is easy to determine the unit of cost for the various parts of a telephone plant. These units of cost were applied by the witnesses to the various parts of the plant of the appellee in the City of Louis-

ville, the result showing by analogy the value of that plant.

The Master considered all of this evidence and made his report to the Court as to the value of the plant.

A summary of these valuations and the conclusion of the Court is shown below:

Value according to D. C. Jackson's Massachusetts report	\$864,800.00
Value according to Chicago report	939,500.00
W. H. Crumb's reproduction value.....	975,000.00
S. H. Leving's reproduction value	1,000,000.00
W. C. Polk's reproduction value.....	1,195,737.00
J. E. Jagoe's reproduction value (see Note) ..	1,590,930.00
The Master found the value of the plant to be.	1,243,011.92
Cost of plant as charged in the Bill of Complaint	1,700,000.00
The lower Court's conclusion as to the value of the plant	1,788,000.00

From the foregoing facts it will be seen that the lower Court not only disregarded the expert testimony of five disinterested telephone engineers and the findings of the Master who heard the witnesses testify, but in order to reach the conclusion that the ordinance was confiscatory, concluded that the only witness for appellee had fixed the value \$200,000 lower than it should have been fixed at, and that even appellee itself, in its Bill of Complaint, had been too modest in valuing its property, and the Court accordingly boosted that value \$88,000.

NOTE. Mr. Jagoe's valuation was \$1,793,540.00 (Record, p. 635). In this was included \$202,610.00 overhead charges (Record, pp. 645, 647, 649, 650). The Court held that overhead charges were not an element of value on which appellee could be allowed to earn a dividend. (Record, p. 1627). Therefore, Mr. Jagoe's valuation should be reduced to the extent of \$202,610.00

There were three erroneous findings of fact by the lower Court which were not sustained by any evidence whatever.

Two of these erroneous findings of fact were in connection with valuing the property, both of which appellee will concede.

The third was an error of law committed by the lower Court concerning what the earnings of appellee would have been under the rate ordinance.

REAL ESTATE.

As regards the valuation of the plant as found by the Court, the facts are these:

Appellee owns the real estate which it uses in the City of Louisville and which is valued by it at \$162,191.42 (Record, p. 763).

It charges as a part of the expenses of conducting the Louisville exchange \$13,800.00 as rental for that real estate; and in addition to the rental all of the taxes and insurance paid by it on account of the ownership of its real estate, making its net income on this real estate exceed 8 per cent. This subject will be discussed later in this brief under the head of expenses.

Appellee does not contend that it should be permitted to treat its real estate as a part of its plant in the City of Louisville on which it is entitled to earn a dividend. (Record, p. 214.)

The amount charged in its Bill as the cost of its plant in the City of Louisville, viz., \$1,700,000.00, does not include the \$162,000.00 representing the value of its real estate. (Record, p. 214.)

The lower Court, however, included in the value of the appellee's plant the \$162,000.00 representing the value of the real estate, not eliminating however from the expense account the \$13,800.00 rental which appellee charged against the Louisville exchange as an expense. The lower Court is, therefore, in the attitude of allowing the appellee to include in its expenses \$13,800.00 rental on its real estate, which is 8 per cent on the value thereof, and allowing it in addition thereto to earn under its rates a reasonable income on the value of that real estate.

The action of the lower Court in the foregoing respect was assigned as error. (Record, pp. 1648, 1651.)

TOLL LINES.

When the appellee purchased the plant of The Ohio Valley Telephone Company in 1900 it acquired toll lines radiating out of the City of Louisville to towns in Kentucky and Indiana which The Ohio Valley Telephone Company said had cost \$125,000.00. The appellee paid a premium on the capitalization of The Ohio Valley Telephone Company, and with that premium charged proportionately against the toll lines and the exchanges the result will show that the toll lines cost \$150,000.00. (See Record, pp. 60, 61.)

The Master in his examination and in reaching his conclusion concerning the toll line earnings was confronted by a complicated situation. He found that the cost of all toll line equipment in Louisville and in the vicinity of Louisville had been charged against the Louisville exchange as a part of the cost on constructing that exchange; that the maintenance of all toll line equipment in and near

Louisville had been charged as part of the expenses of the Louisville exchange; that the salaries of all toll line operators, messenger boys, bookkeepers, collectors and superintendents had been charged as a part of the expenses of conducting the Louisville exchange; that the earnings from the toll line department were due entirely to the existence of the Louisville exchange; that the appellee only credited to the Louisville exchange 15 per cent of the receipts collected on outgoing messages at Louisville, Ky., which 15 per cent amounted to about \$7,000.00 a year, whereas the salaries paid to those employes whose duties were exclusively in connection with the toll line department amounted to over \$12,000.00. This \$12,000.00 did not include any portion of the cost of maintaining the toll property, taxes, insurance or incidental expenses, or the salaries of general officers, local manager or local superintendent.

In view of the foregoing findings the Master reached the conclusion that it would be fair to appellee to treat its receipts on outgoing messages from Louisville as receipts of the Louisville exchange. He accordingly found that to the earnings of the Louisville exchange, as shown by the books of the appellee, there should be credited not only the 15 per cent of the toll earnings which the appellee had credited as part of those earnings, but the entire 100 per cent.

As the logical sequence of such finding the Master held that the cost of the toll lines should be added to the cost of the exchange proper.

The appellee at no time contended that it was entitled to earn on its toll lines, or that the value of its toll lines should be added to the value of its exchange in determining

what amount it should be allowed to earn. And the attitude of appellee in this respect was logical, because it could not well claim that there should be charged against the Louisville exchange as a part of the expense of conducting that exchange \$30,000.00 which was expended solely in conducting the toll department, and that it should at the same time be permitted to earn a dividend on the value of its toll property. In other words, appellee treated its toll lines as a separate investment as concerned its earnings, and as an exchange investment as concerned its expenses.

The Master, however, when he decided to add to the receipts of the exchange all the local receipts of the toll department, naturally concluded that the value of the toll lines should be added to the value of the plant, and the appellee allowed to earn a dividend thereon. In other words, the Master found that all the expenses of operating the toll department should be charged against the Louisville exchange, all of the receipts credited to the Louisville exchange, and the appellee allowed to charge rates sufficient to earn a dividend on the value of that property.

The Court took the opposite view, viz., that the toll department was a separate property and that the manner in which the appellee treated the expenses and earnings of the toll department in its relation to the exchange was correct. Accordingly in its findings the Court permitted the appellee to charge as a part of the expenses of the Louisville exchange all the cost of conducting its toll department, and required it to credit to that exchange about 25 per cent of the toll earnings, which amount did not even cover the salaries of those employees who were engaged exclusively in conducting the toll department.

After reaching the above conclusion it would have been logical for the Court to eliminate from the Master's finding the value of the toll lines, since they had been included by the Master solely because all of the receipts had been credited to the Louisville exchange. Instead of doing so the Court added to the value of the exchange proper the value of the toll lines as found by the Master, viz., \$125,000.00. (Record, p. 1630.) The action of the lower Court in the foregoing respect was assigned as error. (Record, pp. 1648, 1650.)

It will be remembered that the Court fixed the value of the plant at \$1,788,000.00 (see Record, p. 1630). From this there should certainly be deducted \$162,000.00 representing the value of the real estate and \$125,000.00 representing the value of the toll lines. These two sums deducted from the value fixed by the Court on this property leaves a balance of \$1,501,000.00 as the value fixed on the plant by the Court.

Moreover, the Master excluded from the value of the plant on which appellee was entitled to earn a dividend the value of real estate (Record, p. 83). From this action on the part of the Master no exceptions were filed by the appellee.

AN ERROR OF LAW WHICH RESULTED IN THE LOWER COURT HOLDING THAT THE APPELLEE'S RECEIPTS FROM TELEPHONE USERS UNDER THE RATE ORDINANCE WOULD BE \$49,000.00 LESS THAN THEY ACTUALLY WOULD HAVE BEEN.

After the appointment of the Master the City applied to him for leave to have its accountants examine the books and records of the appellee. The appellee objected stren-

nously to this. The Master submitted the matter to the Court and under the advice of the Court overruled the City's application (Record, p. 100).

Appellee then proposed that the City name an accountant, that it also name an accountant, and that the Master appoint these two accountants to examine its books and records.

The City agreed to this proposition still protesting that it had the right, irrespective of such an arrangement, to have its accountants examine appellee's books. Thereupon the Master appointed an accountant upon the recommendation of the City and one on the recommendation of the appellee, and instructed them to examine the books and records of the appellee and report to him the result of their findings either in a joint report or in separate reports. The accountants proceeded to examine the books and made a joint report to the Master wherein they stated that for the year 1908, the last year examined by them, the receipts of the company from its telephone users was \$49,000.00 in excess of what they would have been had the rate ordinance been in force. No witness explains how this conclusion was reached except Mr. H. B. Warren, the City's accountant, who said that the two accountants reached this conclusion (Record, p. 1110) :

"By taking each telephone subscriber as it was listed on said exhibit (Smith's Exhibit No. 6), and taking the revenue that would be derived from the rental rate as indicated by the exhibit, and also taking the rental that would be derived if the rental charged were at the rate as fixed by the ordinance for the same classification of telephones, except in cases where the rate for the services were less than the regular rates for such service, in which case the revenue remained in

both places and in both statements the same as that charged by the Cumberland Telephone Company."

In view of the fact that this record shows that appellee has grossly discriminated among its patrons, the fallacy of the method adopted by the accountants is apparent. For instance, according to the plan adopted by the accountants, where A had a direct business telephone for which he paid \$7.50 per month the accountants deducted \$2.00 from that rate in order to make the rate conform to the ordinance rate, (\$5.50). On the other hand, if B had a direct business telephone and paid only \$3.50 per month the accountants in determining what the earnings would have been under the rate ordinance did not take into account the difference between the \$3.50 and the \$5.50, viz., \$2.00; but assumed that under the rate ordinance the appellee would continue to collect from B only \$3.50.

Here is a simple illustration of what I mean:

	Old Rate.	Ordinance Rate.
A	\$ 7.50	\$ 5.50
B	7.50	5.50
C	3.50	5.50
D	3.50	5.50
	<hr/> \$22.00	<hr/> \$22.00

Had the appellee charged A, B, C and D the ordinance rate it would have received from them the same amount that it did receive from them under the discriminatory rate which it charged in 1908.

The accountants showed, however, under the fallacious plan adopted by them that the appellee would only receive from A and B \$5.50 and would continue to receive from C and D \$3.50, which would result in appellee re-

ceiving \$4.00 less under the rate ordinance than it did receive under the old rate.

This explanation of how the accountants arrived at the item of \$49,000.00 is explained as above indicated by Mr. Warren, the City's accountant.

After Mr. Warren testified, Mr. Wilkinson, the appellee's accountant, gave his deposition and was not even asked whether Mr. Warren's explanation of the plan pursued was correct. Certain it is Mr. Warren's testimony in this respect is not controverted and must be accepted as true.

That the plan pursued by the accountants was fallacious is also clearly shown by a reference to the Bill of Complaint (p. 14, Record in Case No. 197) where it will be seen that appellee contended that the ordinance rates would have reduced its receipts for the year 1908 to the extent of only \$33,504.00.

In accepting the \$49,000.00 item above referred to as representing the fact, the Master said that in view of a statement made by him when he appointed the two accountants he felt it was incumbent on him to accept this \$49,000.00 item. (Record, p. 101.)

Whatever may have been the Master's reason for accepting the \$49,000.00 item as representing the loss, certainly the Court was not bound to accept it unless it was sustained by the evidence. *For instance, if the accountants had reported as a fact that the land on which was located the main exchange had cost \$300,000.00, and had the actual voucher representing the purchase price been produced, showing that it cost only \$100,000.00, there being no evidence to the contrary, would the Court have been bound to find that the property in question cost \$300,-*

000.00? And consequently that appellee was entitled to a return on \$300,000.00? Such is precisely the situation which is here presented.

The Court is in the attitude of holding that a matter referred to a Master, can in return be referred to an expert, and that the report of the expert not only unalterably binds the Master, but the parties and the Court.

The case of *Kimberly vs Arms*, 129 U. S. 512, was a case in which a *consent order* had been entered directing the Master to ascertain and decide all questions of law and fact arising under the issues in the case, and to report its findings to the Court. The lower Court set aside the Master's report and on appeal this Court (Mr. Justice Field delivering the opinion) discussed at length the effect of such an order of reference. In the course of the opinion it was said that while such a reference was not strictly a submission of the controversy to arbitration, yet it was in effect,

"a submission of the controversy to a tribunal of the parties' own selection, to be governed in its conduct by the ordinary rules applicable to the administration of justice in tribunals established by law. Its findings, like those of an independent tribunal, are to be taken as presumptively correct, subject, indeed, to be reviewed under the reservation contained in the consent and the order of the Court, when there has been manifest error in the consideration given to the evidence, or in the application of the law, but not otherwise."

The order in this case was not a consent order.

If the parties cannot themselves by consent submit a matter to a Master and thereby bind the Court, how can the Master, to whom no such reference has been made, submit that question to some third person not known to

the Court, and without the knowledge of the Court, and thereby bind the Court?

The action of the lower Court in respect to this \$49,000.00 item was assigned as error. (Record, p. 1650.)

Concerning this phase of the case the City's accountant testified at great length, and it was shown beyond a doubt that had the rate ordinance been in effect in 1908 the appellee's receipts from its subscribers would have been a few thousand dollars in excess of what they actually were under the old discriminatory rates. (See Record, p. 1100 to 1105).

That the accountants proceeded on the wrong theory is apparent. That it was error on the part of the Court to accept their figures is shown conclusively by the opinion of this Court in the Knoxville Water case where it was held that the water company had the right to charge every consumer the amount fixed in the ordinance and that if it chose to charge less it did so at its peril.

Here is what this Court said on that subject:

"If it stood upon the letter of the ordinance, as it had the right to do, and exacted from the consumers the full charges prescribed by the ordinance, the amount which would have been realized would have been over \$4,000.00 more than that found by the Master, or a net income of not less than, \$40,000.00."

If, therefore, the appellee *stands upon the letter of the ordinance as it has the right to do*, and exacts from its patrons the full charges prescribed by the ordinance, its earnings for the year 1908 would have been a few thousand dollars in excess of what it actually did receive under the rates then in force.

The lower Court found the earnings for the year 1908 to be \$330,926.38 (Record, p. 1631). The Court seems to have accepted the Master's findings as to expenses, viz., \$216,363.07 (Record, p. 1632), making the net earnings for the year 1908, \$114,563.07. From this amount the Court said there should be deducted \$49,000.00 representing the difference between what the appellee did receive from its subscribers and what it would have received had the rate ordinance been in effect, and the Court then proceeded to hold that on its valuation of \$1,788,000.00 appellee would earn under any state of case less than 6 per cent and possibly as low as 3 per cent.

The Court found that appellee was entitled to earn at least 7 per cent on its property (Record, p. 1639); that any amount less than 7 per cent on the value of its property would be equivalent to confiscation, but that if appellee could earn 7 per cent or more on the value of its property then the ordinance was not confiscatory.

When the palpable errors made by the lower Court as above detailed are taken into consideration, it will be shown beyond the peradventure of a doubt that according to the Court's own findings of fact the appellee would have earned in the year 1908 more than 7 per cent on the value of its plant had the rate ordinance been in force.

Court

The Master fixed the value of the plant at...	\$1,788,000.00
From this should be deducted the value of the real estate	162,000.00
Leaving a balance of	\$1,626,000.00
From this balance should be deducted the value of the toll lines	125,000.00
	<hr/> \$1,501,000.00
Gross earnings for the year 1908	\$ 330,926.38
Expenses for the year 1908 including main- tenance and depreciation	216,363.07
	<hr/> \$ 114,563.31
Net earnings for the year 1908	\$ 114,563.31
7 per cent on \$1,501,000.00	105,070.00
Margin over and above 7 per cent	<hr/> \$ 9,493.31

Every witness stated that the lowering of the rates would increase business and the Master found from the evidence that within two years after the rates were lowered the gross receipts would increase \$49,000.00 (Record, p. 88).

These preliminary suggestions dealing with the opinion of the Court are made for the purpose of saving the Court the necessity of wading through a mass of evidence in order to determine the real merits of the appellee's contention concerning the confiscatory nature of the ordinance in question.

As to the two items representing the value of the real estate and the value of the toll lines I have said sufficient to show that the lower Court erroneously included those two items in its valuation.

That toll lines are not treated by the appellee as a part of the Louisville exchange, and that it nowhere contended in this record that the value of those toll lines should be added to the value of the exchange is shown in the exceptions which appellee filed to the Master's report (Record, p. 121). Appellee in expressly excepting to the action of the Master in adding to the value of the plant the value of the toll lines said:

"The evidence is clear that the toll line construction is kept separate and distinct from exchange construction, and its cost or value does not appear in this record for the reason that Your Honor directed the Master to ascertain the cost and value of the Louisville exchange, and not the cost and value of the Louisville exchange plus the toll line system of the complainant." (See also record, page 211.)

That appellee never added to the value of its plant the value of its real estate and never sought to earn a dividend thereon other than the rental it charged therefor is shown clearly by the record. (See p. 214.)

Mr. Smith, the Auditor, in his direct examination testified as follows:

"In this connection it would be proper to explain the following: first, the real estate owned by the company in the Louisville exchange is not included in the cost of plant as shown in Exhibit No. 1. The rental which the company would have to pay for the quarters occupied if leased from other parties, is estimated, and this rent is apportioned between the various items of expense on the basis of space occupied." (Record, p. 214.)

As to the \$49,000.00 item representing what the loss would have been under the rate ordinance I have only

briefly discussed that phase of the case. The facts concerning that item are discussed in detail on page 147 of this brief.

Before discussing the value of the plant, the expenses and earnings of the appellee as shown by the record, I wish to call attention to one or two preliminary questions involved in this case which entitle appellant to a reversal irrespective of whether the ordinance if enforced would confiscate appellee's property.

APPELLEE IS A TRESPASSER AND NOT ENTITLED TO RELIEF IN A COURT OF EQUITY.

In the first place, if the contention made by the City in case No. 197, City of Louisville vs. Cumberland Telephone & Telegraph Company (which case is being heard with this case), be upheld, then at the time the Bill of Complaint was filed, appellee was occupying the streets of the City of Louisville without authority of law; was a wrong-doer and a trespasser, and under the maxims of equity was not entitled to seek relief in a Court of Equity. That appellee is not entitled to seek relief in a Court of Equity under the circumstances is upheld by the Court of Appeals of Kentucky, Michigan and Ohio.

I call attention to the case of Rough River Telephone Company vs. Cumberland Telephone & Telegraph Company, 119 Ky. 470. There it was contended by a telephone company which had no franchise to occupy the streets that it was being deprived of the power to earn money. The Court of Appeals of Kentucky in disposing of the case used this language:

"The injury arises in both cases from depriving the corporation of the power to earn money by the

operation of its franchise. A mere trespasser cannot complain that he is prevented from continuing his wrongful act. No injury is claimed to the corporeal property of appellee. The sole injury is the prevention of the full exercise of its invalid claim of a franchise in the streets of the city. It follows, therefore, under the authorities cited, that, as it has no such franchise, it can have received no injury of which equity will take cognizance."

In the case of Rural Home Telephone Company vs. K. & I. Tel. Co., 32 Ky. Law Rep. 1072, the Court of Appeals said:

"Upon what theory can the Kentucky & Indiana Telephone Company, that has no franchise to establish or conduct a telephone system in Owensboro, compel the Rural Home Company to do business with it? While violating the Constitution and the Statute, with one hand, the appellant company is asking with the other, the protection of the Court. This protection the Court, under the circumstances, will not afford."

See also East Tennessee Telephone Company vs. Russellville, 106 Ky. 669.

Bland vs. Cumberland Telephone Company, 109 S. W. 1180.

The case of Bridge Company vs. Prange, 35 Mich. 400, was a case in which Chief Justice Cooley delivered the opinion. That case involved the right of the Bridge Company to collect tolls after the expiration of its franchise. The Michigan Court denied to the Bridge Company the right to collect tolls, using the following language:

"The estate of the corporation in it was expressly limited to twenty years, and when that period came to an end the estate ceased, also. There was no longer color of law for taking tolls, and the failure of the

State to institute proceedings could no more continue the franchise or restore it to life than the like failure in the case of one who should erect a gate across a common highway and levy like tolls. * * * A waiver cannot renew an estate which has expired by limitation."

The case of Cincinnati Inclined Plane Railway Company vs. City of Cincinnati, 44 N. E. 327, raised the question of whether the Inclined Plane Railway Company had a franchise to occupy the streets of the City of Cincinnati and also whether it was liable for license fees after the expiration of its franchise. The Court held that the Railway Company was without a franchise and denied to the city the right to collect license fees after the expiration of the franchise. Here is an excerpt from the opinion touching the subject:

"We cannot accept the contention of the city, however, that the defendant is also liable for license fees from 1884 to the date of the filing of the petition in this case, because the grant had expired in 1884, and, as we have previously found, was not renewed, either expressly or impliedly. The defendant, therefore, during that period of time, was a mere trespasser upon the streets, and did not occupy them by virtue of any contract between it and the city; and it is only by virtue of a contract, express or implied, that it could be made liable for license fees."

This record shows that the City of Louisville has offered and is willing to sell appellee a franchise to occupy the streets (Record, p. 41). Therefore, if appellee is a trespasser it is because it has not accepted the offer of the City. I submit that it is not consonant with the high functions of a Court of Equity to permit a complainant to convert to its own use, without right, a portion of the

streets of a city; to refuse to procure from such city a right to use its streets, and then, when the city seeks to make regulations governing the use of its streets, for such complainant to come into a Court of Equity and seek relief from those regulations.

WANT OF FRANKNESS ON THE PART OF THE APPELLEE IN THE MATTER OF DISCLOSING THE FACTS CONCERNING ITS BOOKS AND RECORDS.

I first call attention to the language of this Court in the Knoxville Water case (City of Knoxville vs. Knoxville Water Company, 212 U. S. 16):

"It (rate regulation) is a dangerous and delicate function and ought to be exercised with a keen sense of justice on the part of the regulating body, *met by a frank disclosure on the company to be regulated.* The Courts ought not to bear the whole burden of saving the property from confiscation."

As both the Master and the lower Court based their calculation concerning the value of the plant upon what it had cost, it is therefore important to determine the reliability of the books of the appellee upon which the cost of the plant was necessarily based. Appellee purchased the plant in 1900. It charges that it expended \$1,023,000.00 in construction work between that date and March, 1909.

The auditor of the company said in his deposition that of this amount \$518,000.00 represented material furnished to the Louisville exchange from the supply department at Louisville. (Record, p. 1043.) It seems that appellee has in connection with its Louisville exchange a supply department which furnished to Louisville and the Louisville district all of its supplies. The Louisville district according to appellee's auditor (Record, pp. 283-296) comprises

the towns surrounding Louisville within a radius of one hundred miles, including those in Ohio, Indiana and Illinois.

The cross-examination of appellee's auditor constantly lead to the point where it was necessary to see the vouchers from the supply department. Mr. Smith was asked time and again to produce those supply vouchers, but he persistently refused to do so. (Record, pp. 362, 363, 280.)

The method of making these charges against the Louisville exchange was as follows:

The Engineering Department would at the end of each month send to the auditor a slip of paper on which he had written a memorandum to the effect that there should be charged against the Louisville exchange a certain sum representing material taken from the supply department during the preceding month. There was no record showing what material was furnished, when it was furnished, whether it was for reconstruction or construction purposes, or in fact anything whatever except an order to make a charge against the construction account of the Louisville exchange.

The auditor was the only official put forward by the appellee to make out its case and the only official who made any pretense of knowing what the appellee had expended in the construction of its plant in Louisville. The auditor was certainly on four different occasions asked to produce these vouchers and in every instance refused to produce them. In other words, the auditor of the company is in the attitude of giving testimony in substance as follows:

Q. You have charged on your books as part of the cost of constructing the Louisville exchange the sum of \$518,000.00. What does that item represent?

A. It represents material taken from the supply department at Louisville and turned over to the proper employes of the Louisville exchange.

Q. How do you know that to be true?

A. That is our system.

Q. Have you any records in your office showing that \$518,000 worth of material was furnished the Louisville exchange?

A. None except memoranda such as this.

Read that memorandum.

A. To the auditor. Charge against construction account of Louisville exchange \$500.00, signed Engineer.

Q. Are there any records showing of what that material consisted?

A. Yes, in the engineer's office adjoining my office.

Q. Will you produce those records?

A. I decline to do so.

In the argument below counsel for appellee insisted that he should have been requested to produce these vouchers. I submit that it was the duty of the appellee to produce them and permit an examination of them. It was not incumbent on the appellant to look up the attorneys of the appellee and beseech them on bended knee to produce these vouchers. The appellee put forward one man and only one man to make out its case in so far as the expenditures for construction were concerned. That man was asked time and again to produce these vouchers and he declined on every occasion to produce them.

Moreover, on one of these occasions when the auditor was asked to produce vouchers from the supply department, Mr. Granbery, chief counsel for the appellee, was present and declined to permit his witness to produce these

vouchers. Here is the evidence which speaks for itself (Record, p. 280) :

"Q. Now, I show you another paper contained among the papers as a part of this voucher, dated Lewisburg, Tenn., April 20, 1900, Cumberland Telephone & Telegraph Co., Nashville, Tenn., a number of poles aggregating in value \$127.15, freight \$26.95, which seem to have been shipped from Nashville, Tenn., to O'Bannon, Ky., and which also has endorsed on it in pencil, Louisville, Ky. Will you examine that paper and tell me who placed that endorsement in pencil on that paper?

"A. Mr. J. L. Pearcey, Jr.

"Q. What does that endorsement mean?

"A. It means that the invoice should be charged to the construction—aerial account of the Louisville, Ky., exchange.

"Q. Do you know where O'Bannon, Ky., is?

"A. I do not.

"Q. Do you know it is at least twenty miles from Louisville?

"A. I do not.

"Q. Do you know whether or not these poles were used in connection with the construction of the Louisville exchange?

"A. I have no reason to doubt that they were.

"Q. Do you know that they were?

"A. Personally no.

"Q. Does anybody personally know connected with your office?

"A. I think the supply department would have secured information to determine that before charging it.

"Q. Can you produce anybody connected with the supply department and will you produce a witness who will testify that the poles represented on that paper I have read you, were used in constructing the Louisville exchange?

"Mr. Granbery: I object to the question because this witness is not supposed to be furnishing other witnesses. He is here to testify as to what he knows and not to produce witnesses for examination.

"Mr. Blakey:

"Q. You are an official of this company, are you not?

"A. I am."

There is scarcely a page of Mr. Smith's deposition covering 573 pages wherein evidences of lack of frankness does not appear.

The attitude of appellee's chief counsel as concerned the books of the company was most remarkable. After the two accountants had made their report to the Master, I proceeded to cross-examine the Auditor. One of the first questions asked the Auditor necessitated an inspection of certain books which were not in the chief counsel's office where the deposition was being taken. The witness started to retire and obtain the information when the following took place (Record, p. 249) :

Mr. Blakey:

"Note there that Mr. Blakey asked Mr. Smith if he had any objection to Mr. Warren, who is assistant to Mr. Blakey, going with him. Whereupon Mr. Smith stated he had no objection and Mr. Granbery directed Mr. Smith to go ahead, that Mr. Warren had nothing whatever to do with the matter and would not permit him to go with Mr. Smith."

Mr. Granbery:

"Mr. Granbery states he does not know Mr. Warren to be Mr. Blakey's assistant, or a lawyer at all, but understands he is assistant to Mr. E. W. Farnham representing the Mutual Audit Co. who has made a report to the Master Commissioner in this case. Mr. Granbery also says he has not the slightest objection to Mr. Blakey going with Mr. Smith and looking at the original entries if he desires."

Mr. Blakey:

"Of course, Mr. Granbery, there will be a number of matters I will want Mr. Warren to examine, in connection with the books of the company, and I want to get a ruling of the Master as to whether he shall be permitted to make such examination of records as are called for. If you object to that, I should like to know in order that I may telegraph the Master to come here and make a ruling on it."

By Mr. Granbery:

"I am not prepared to deal with any question that may arise until it arises."

Mr. Blakey:

"I will then ask you, instead of having Mr. Smith to look these records up himself, to present them here for inspection."

Mr. Granbery:

"Mr. Smith will present any record pertinent to this law suit which you may call for for your inspection."

The witness retired and returned with the record which was handed to counsel for appellant, who thereupon began to examine it in connection with Mr. Warren, who was the City's accountant. The following then occurred:

Mr. Granbery:

"Mr. Warren, that book is not for your inspection."

Mr. Blakey:

"Mr. Warren, you are here for that purpose."

Mr. Granbery:

"If Mr. Warren is to look at these books, I shall have to insist he does not do so, and I am not going to permit Mr. Warren to look at the books, and there is

one way of preventing it but that, of course, I should regret very much to have to do. I have not the slightest objection to Mr. Warren being present and aiding counsel in any data or suggestions he desires, but so far as looking at the books of the company, they are not here for that purpose, and I shall not permit him to do so."

Mr. Blakey :

"I ask the stenographer to certify to the Master the fact that certain books were produced for inspection, the books referred to by the witness, and that counsel for complainant, after they were produced, objected to the representatives of the City inspecting the books, and that counsel for the defendant then and thereupon requested the stenographer to certify to the Master, the fact that such refusal had been made, and asked for a ruling as to whether the City's representatives should be allowed to inspect the books, which were called for and produced by the witness."

Mr. Granbery :

"Mr. Stenographer, just take this. In making any certification to the Master, you will please state exactly what occurred as indicated by your notes."

The further taking of these depositions was thereupon adjourned until the Master can be heard from.

A ruling was had from the Master to the effect that the City's accountant should be permitted to inspect all books and records which were produced by the witness. (Record, p. 251.)

When the cross-examination was resumed several questions were asked in regard to figures and items appearing on the book which Mr. Smith had produced, whereupon it became necessary for Mr. Smith to retire and produce another book. During the interval at the request of counsel for the City Mr. Warren examined the first book which

the witness had produced, whereupon the following occurred:

Mr. Granbery for complainant:

"Mr. Warren, that book is not for your general inspection, but we will just follow the rule of the special master. Thereupon Mr. Warren surrendered said book." (Record, p. 252.)

The following instances are only a few of the many evasive answers showing with what difficulty evidence was extracted from Mr. Smith, and showing conclusively his lack of frankness and willingness to disclose fully the facts in regard to the company's books and records.

On one occasion Mr. Smith produced a voucher showing that there had been charged against the construction of the Louisville plant, an item for constructing a toll line from Winchester to Mt. Sterling, Ky. Mr. Smith had been so emphatic in his statement that no toll line cost had ever been charged against Louisville that I saw fit to ask him about this particular voucher. Here is what he said:

"Q. I hand you voucher No. 702 May 1907, which seems to be a pay-roll voucher for the East Tennessee Telephone Co., amounting to \$220.60, \$152.76 of which seems to be charged to Louisville. I call your attention to a notation on the voucher which reads as follows: 'Running line orders from August 1st, to August 9th, reconstructing Winchester and Mt. Sterling toll line August 10th to August 30th, and I will ask you whether any part of that pay-roll represented by this voucher was charged to Louisville exchange construction account, if so, what part and state whether it was correctly charged, if so charged.'

"A. Mr. Wilkinson's report, page 25, shows that this item was incorrectly charged to Louisville Construction Account and such is admitted by me.

"Q. Would not that notation indicate that at least a part of the work should have been charged to toll line reconstruction?

"A. It would indicate that an expenditure chargeable to maintenance, or what we term, or the foreman terms, a line between Winchester and Mt. Sterling, was made. He calls it a toll route; at the present time I don't know just what is on the route.

"Q. Do you know whether it was a toll line or not?

"A. I do not.

"Q. Do you know how far Winchester and Mt. Sterling are apart?

"A. I do not.

"Q. If they are 30 miles apart would you call it a toll line?

"A. Might be.

"Q. If it was reconstructing a line from Winchester to Mt. Sterling, which are thirty miles apart, would you say it could be anything else but a toll line?

"A. Yes.

"Q. What could it be?

"A. It might be that part of the route which bears subscribers of the Winchester Exchange and also of the Mt. Sterling Exchange.

"Q. The presumption is that it was a toll line as it says toll line?

"A. Your presumption is.

"Q. What is your presumption?

"A. Mine is that I don't know. I want it to be clear though that the case does not affect Louisville.

"Q. Your presumption is when a voucher says it was done on toll line, you don't know what it was done on?

"A. I say, the foreman thinks it was done on a toll line.

"Q. If it was done on a toll line, then you have charged up as part of the construction of the Louisville exchange work done on a toll line?

"A. Absolutely none.

"Q. This was charged up as part of construction?

"A. No, reconstruction.

"Q. I didn't say anything about reconstruction. I said construction.

"A. A part of the pay-roll is incorrectly charged to Louisville Construction account.

"Q. Where was that voucher paid?

"A. It was cashed in the Louisville, Ky. office. Louisville cashier's office.

"Q. Was Winchester in the Louisville District?

"A. It is under the Superintendent at Louisville." (Record, pp. 294-295).

In connection with what constituted the district over which the chief officer at Louisville presided, Mr. Smith testified as follows (Record, p. 283):

"Q. What territory is embraced under the jurisdiction of your chief manager at Louisville, chief officer at Louisville?

"A. At the present time.

"Q. Just generally speaking, Mr. Smith?

"A. The exchanges are as follows: Anchorage, Ky., Borden, Ind., Greenville, Ind., Georgetown, Ind., Harrods Creek, Ky., Jeffersontown, Ky., Jeffersonville, Ind., Louisville, Ky., New Albany, Ind., Pewee Valley, Ky., Pleasure Ridge, Ky., St. Matthews, Ky., Utica, Ind., West Point, Ky.

"Q. What represented the district over which your chief officer at Louisville, had jurisdiction in the year 1900?

"A. I will have to send upstairs to get it. It will probably take an hour to do that, as we will have to go through the vouchers.

"Q. Have you any general idea about what district was covered in the district I have asked about?

"A. Well, New Albany, Jeffersonville--

"Q. The one you have already named?

"A. If they were in existence, probably, yes.

"Q. What other territory?

"A. No other. It was not as extensive in 1900 as in 1909.

"Q. Was it ever more extensive than it is now?

"A. No, never as extensive as it is now."

On page 296 of the record will be found statements from Mr. Smith which are at variance with the above testimony and which at least show that he was evasive (Record, p. 296):

"Q. Was Winchester in the Louisville district?

"A. It was under the superintendent at Louisville.

"Q. Over what territory has the superintendent jurisdiction?

"A. The Louisville superintendent.

"Q. Yes?

"A. Over Southern Indiana and Central Kentucky; at the present time his jurisdiction is as far west as the eastern counties in Illinois.

"Q. How far north?

"A. As far as the territory of the Cumberland Company extends now.

"Q. How far is that?

"A. It embraces the counties in Indiana which border the Ohio River.

"Q. How far does that territory extend?

"A. I will have to refer to my files.

"Q. How far south?

"A. The general answer I will give you is, Central Kentucky. If you wish more detailed information I will have to ask for time to get it.

"Q. This morning you gave a list of towns which were included in the Louisville District; that is a sub district is it, and the district over which the superintendent has jurisdiction?

"A. Yes, this morning you asked me for the jurisdiction of the manager."

On another occasion Mr. Smith was explaining the custom among connecting companies to credit to the exchange only fifteen per cent of the toll earnings. I wished to know whether those connecting companies were Bell or Independent companies. In other words, whether they were all companies owned by the American Company. I,

therefore, asked the following questions and got the following answers:

"Q. Are they what is known as Independent telephone companies or Bell Telephone companies?

"A. They are independent telephone companies.

"Q. Well, there is a Bell system of telephones and an independent system of telephones, are there not, in the United States?

"A. I believe there are systems designated as that; the exchanges of the telephone companies to which I refer are those which were built and are owned I think entirely locally.

"Q. Do you receive messages and transmit messages over any telephone system known as the Independent System of Telephones or affiliated with the Independent Telephone System?

"A. The hundred or more companies that I have just mentioned are in themselves independent.

"Q. I understand, they are independent from your company, but are they what is known as the 'Independent,' or 'Home' telephone system, in contradistinction to the 'Bell' system?

"A. They are not competing companies, if that is what you mean.

"Q. That is not what I mean; I mean are they affiliated with or associated with what is known as the Bell system of telephones as contradistinguished from the Independent or Home system of telephones?

"A. These companies that I refer to are independent in their management and I believe some of them have the word 'Home' in their titles." (Record, p. 467).

Whereupon I despaired of getting the real facts.

Again Mr. Smith testified as follows (Record, p. 225):

"Q. Now, in your deposition on Monday, the third item bills payable \$221,005.09, can you furnish me an itemized statement showing those bills payable?

"A. I can.

"Q. Have you it before you?

"A. I have not.

"Q. Have you vouchers representing those payments?

"A. I think so.

"Q. Have you before you an itemized statement of those payments?

"A. I have not.

"Q. In what records do they appear in your office?

"A. In the ledger of the company.

"Q. Will you produce the ledger for inspection?

"A. I will do so.

"Q. On what page is it?

"A. You have the ledger. There is an index in there.

"Q. Will you kindly indicate to me in this ledger where I will find a list of the items that go to make up this total sum of \$221,005.09?

"A. By referring to the index under notes payable you will find the page."

So much for the attitude of the Auditor and General Counsel of the company.

Mr. Caldwell, the President of the company, is the only other officer who testified to any material fact.

So far as Mr. Caldwell is concerned it is sufficient to call attention to the language used by the lower Court in speaking of Mr. Caldwell's deposition, which is as follows:

"The grossly profane outbreak of the president of the complainant while giving his deposition was as inexcusable as it was suggestive." (Record, p. 1638).

Mr. Caldwell practically ordered the City's accountants out of the appellee's building at a time when they were working on the books of the appellee under the orders of the Master. (Record, p. 1044).

Before the motion for a temporary injunction was made the City made an application to the Court for leave to

have its Engineer inspect the plant of the appellee. Counsel for appellee opposed the motion and the Court refused to grant such permission. (Record, p. 651).

Where a public service corporation seeks to have a rate ordinance declared invalid because unreasonable, the burden of proof is on the complainant, and it is its duty to frankly disclose all the facts bearing on the subject.

Instead of refusing to the City the right to examine its books except under the espionage of one of its hirelings; instead of trying in every manner possible to conceal the real facts; instead of declining to produce its books and records until forced to do so; instead of giving evasive answers to questions concerning its records, the complainant should court investigation; should furnish to the City and to the Court every assistance in bringing out the real facts concerning its books and records. "The Courts ought not to bear the whole burden of saving the property from confiscation." The appellee has pursued a course diametrically opposite to the course which this Court said should be pursued by public service corporations when it questions a legislative rate. Appellee has thrown upon the Court the entire burden of saving its property from confiscation.

The action of the lower Court in the above respect was assigned as error. (Record, p. 1646.)

THE ORDINANCE RATES ARE REASONABLE.

The Court appointed a Special Master with instructions to ascertain the facts bearing on the question of whether or not the rates named in the ordinance were confiscatory. The Special Master made the examination called for in the Order of Reference, and reported to the Court concerning

the cost of the plant, the value of the plant, the earnings and expenses over a period of four years, what the probable earnings would be under the rate ordinance, and certain other facts not necessary to mention. In the following pages I will discuss the evidence under the headings above indicated.

COST OF PLANT.

The appellee charged in its Bill of Complaint that its plant in Louisville, Ky., had cost \$1,700,000.00. (Record, p. 54).

The two accountants stated that according to the books of the appellee its plant at Louisville, Ky., had cost \$1,702,000.00. (Record, p. 742).

The Master found that appellee's plant at Louisville, Ky., had cost it \$1,381,000.00. (Record, p. 70).

The Court found that the appellee's plant at Louisville, Ky., had cost it \$1,745,000.00. (Record, p. 1624).

As both the Master and the Court based their valuation of the plant to a certain extent on its cost it is essential to examine the record in order to determine what the plant of appellee did cost.

As stated above the two accountants in their joint report said that *the books of the company as they were kept* showed that the plant had cost \$1,702,000.00.

The joint report also had the following qualifications embodied in it:

"The foregoing joint report shows the money charged as the cost of the plant at Louisville * * * * as recorded on the books of the Cumberland Telephone & Telegraph Company. It is not an agreement that

the said accounts are properly distributed or charged as we believe they should be."

In separate report of the City's accountant it was shown that the plant did not cost in excess of \$1,317,000.00. (Record, p. 1313).

PURCHASE OF THE OHIO VALLEY TELEPHONE COMPANY.

The appellee purchased the plant of The Ohio Valley Telephone Company at Louisville, Ky., including the toll lines and exchanges in nine cities and towns surrounding Louisville. The method of its purchase was by acquiring the stock of that company. That company had \$550,000.00 capital stock. For 3557 shares of that stock it paid a premium of \$40.00, which amounted to \$145,135.00. The remaining 1937 shares of that stock had been issued to the American Telephone & Telegraph Company as a bonus and was exchanged for a similar number of shares in the appellee company, so that the appellee paid \$550,000.00 plus the premium of \$145,000.00 for The Ohio Valley Telephone Company. (See Record, pp. 60, 61, 62.)

Capt. Gifford, who organized The Ohio Valley Telephone Company and who was the general manager of it during its entire existence, stated that for ten years prior to the sale, the company had paid a 7 per cent dividend on its capital stock, was in excellent condition at the time of the sale, and that its current liabilities did not exceed its current assets. (Record, pp. 959-963.)

Appellee, therefore, acquired the property of The Ohio Valley Telephone Company for \$700,000.00. After purchasing the property appellee proceeded to place on its

books separately the ten or eleven exchanges and the toll lines.

The balance sheet of The Ohio Valley Company showed that in placing a value on this property it valued the toll lines at \$125,000.00. (Record, pp. 1326-273.) This would leave a balance of \$575,000.00 as representing the value of the exchanges. The appellee treated the Louisville exchange as representing 80.4 per cent of the value of all the exchanges. (Record, p. 61.) On this basis the Louisville exchange would have been placed on its books as representing a cost of \$460,000.00. Instead, however, of placing the Louisville exchange on its books at the last named figure, it placed on its books \$835,918.00 as the sum representing the cost of the Louisville exchange. (See Record, p. 1573.) Later it seems to have realized the absurdity of such a charge and it reduced this figure to \$678,000.00. (Record, pp. 245-246.) The auditor explained this \$678,000.00 in his deposition by saying that the company added to the \$550,000.00 capital stock of The Ohio Valley Telephone Company the \$145,000.00 premium, and also \$79.00 representing the premium which it would have been required to pay the American Telephone & Telegraph Company had it purchased its stock, and also the sum of \$135,000.00 which The Ohio Valley Telephone Company over a period of ten years, had charged off the value of its plant on account of depreciation which it said had taken place over a period of ten years, and which the appellee said had not taken place. Of this total the appellee thought \$678,000.00 was a fair representation of what the Louisville exchange had cost. (Record, p. 245.)

The Master refused to accept these figures of appellee's auditor and decided that the appellee had paid for The

Ohio Valley Telephone Company \$457,000.00. (See Record, p. 62.)

The lower Court did not discuss this phase of the case at all, and it must be assumed that the exceptions to the Master's report in this respect were not overruled.

Of course, the accountants in reaching their conclusion accepted the items as they appeared on the books.

The item appearing on the books as the price paid by appellee for the Louisville exchange was \$678,000.00 and the accountants simply accepted that item without question. It was only through numerous pages of cross-examination of the auditor that the facts were brought out which justified the Master in reaching his conclusion as above indicated. (See Record, pp. 246 to 275.)

COST OF CONSTRUCTION SINCE 1900.

The accountants found that beginning with \$678,000.00 on January 1, 1900, the books of the company showed added construction up to January 1, 1909, amounted to \$1,023,000.00 or a total cost of the plant of \$1,702,000.00.

This added construction appears on the books of the company under the following headings:

Payrolls for labor.

Supplies.

Equipment.

Tools and teams.

Poles and wires.

Credits to construction.

PAYROLLS FOR LABOR.

The records in the appellee's office show monthly payrolls on which appear the names of all laborers doing

any work in connection with the Louisville exchange. Following the name of each laborer is a notation showing what class of work he does and whether it is construction or reconstruction work. When cross-examining the auditor I called for payrolls for January, March, April, July, September and November, 1900. (See Record, pp. 301 to 306.) Without exception the wages of every man who could possibly have done any kind of construction or reconstruction or maintenance work was charged to construction account. Vouchers amounting from \$1,100.00 to \$3,000.00 were charged exclusively to construction account during the entire year with the exception of small items running from \$100.00 to \$210.00. For instance, in the payroll of September, 1900, which is a fair example, Mr. Smith said the entire amount was charged to construction account except the wages of the following named men, who were paid \$210.00 one month: F. Weick, foreman; J. Lally, night watchman; G. Wathan, clerk; C. Coon, trouble man; F. Freck, trouble man; D. Gwyn, instrument man; A. Moraweck, wire chief; L. Newhouse, assistant stockkeeper; C. Stephens, instrument setter. (Record, p. 305.)

It is self-evident that the company charged during the year 1900 to construction account not only the wages of the men who were engaged in construction work, but also the wages of men who were engaged in reconstruction work and maintenance proper.

The January, 1901, payroll shows the same state of case as that for the year 1900. (Record, p. 305.)

Beginning with July, 1901, however, the company seems to have realized that it had been charging entirely too

much to construction, so it veered around and in July, 1901, went to the other extreme and charged \$2,013.00 of the payroll out of the total of \$2,046.00 to maintenance. (Record, p. 306.) Mr. Smith said that this was erroneously done, that this amount should have been charged to construction, and that subsequently an entry was made for the year 1901 adjusting these charges as between construction and maintenance. (Record, p. 701.) The June payroll for 1901 shows the same situation as the July payroll. In October, 1901, however, the old system of 1900 was again installed and out of a total of \$3,192.00, the payroll for that month, over \$3,000.00 of it is charged to construction. (Record, p. 315.)

As Mr. Smith said these payrolls were a fair example of payrolls for the entire period I did not think I could afford to devote further time to the examination of these payrolls. (Record, p. 302.) I may say that the examination of these payrolls extended over at least three days.

SUPPLIES.

I have discussed the item of supplies from the supply department under the heading "Want of Frankness" and will content myself with simply referring the Court to pages 50 to 53 of this brief.

Attention should also be called to the fact that 10 per cent is added to the cost of all supplies furnished the Louisville exchange by appellee. (Record, pp. 64-327.) These supplies amounted to \$518,000.00. Therefore, there were \$51,000.00 added to the cost of the Louisville exchange which represents no part of the cost of the ex-

change. The auditor contended that this 10 per cent represented freight, drayage and rental.

As to rental the rent of the warehouse wherein the supplies are stored is paid by the Louisville exchange.

As to taxes, the taxes on all the property in Louisville is paid by the Louisville exchange.

As to freight, the auditor produced numerous vouchers showing that all freight is charged against the Louisville exchange. (See Record, pp. 284, 295, 296, 297.)

EQUIPMENT.

The equipment includes Central Office Equipment and Subscribers Equipment. Central Office Equipment consists of switchboards inside the exchange proper.

An ex-cashier of the appellee showed that the company installed during the year 1902, five sections of switchboards and thereafter removed the same sections from the building without ever having used them. (Record, pp. 983-984.)

The auditor produced a voucher representing the expenditure of \$26,000.00 for installing five sections of switchboard in the main exchange in 1902. (Record, p. 335.)

Mr. Smith stated that, that \$26,000.00 was now represented on the books of the company as part of the cost of constructing the Louisville exchange. Those five sections are not now in the main exchange and were never used in the main exchange, as will be shown in the discussion of the value of the plant. (See this brief, p. 111.)

SUBSCRIBERS EQUIPMENT.

This item involves a most complicated situation. The record discloses that the company has treated its sub-

scribers equipment, as concerns charging it to construction account, in every imaginable manner.

Mr. Smith said that the " subscribers stations equipment, including poles, extension bells, desk phones, booths, pay stations, apparatus, etc., and the labor and other expense incident to putting the apparatus in condition and ready for service" is charged to construction. (Record, p. 218.)

He also said "the total cost of installing new (speaking of subscribers) equipment is charged to construction." (Record, p. 349.)

I then proceeded to have him give his reason for this charge, whereupon he said that this plan was abandoned after a few years and only the apparatus charged to construction. (Record, p. 351.) I then asked him if any additional sum was charged to construction over and above the cost of the instrument and the labor of installing it, to which he replied that a charge of \$10.00 was made against construction for all instruments gained, and he proceeded to explain that when instruments were lost no extra charge of \$10.00 was made against construction. (Record, p. 351.) He said, however, that "in case Louisville had shown a loss Louisville would have been charged with some part of \$10.00." (Record, p. 356.) He further said that the \$10.00 plan was abandoned many years ago (Record, p. 353), and yet I had him produce a voucher showing that it was in effect as late as May, 1907. (Record, p. 354.)

Mr. Jagoe, an employe of appellee, said:

"Q. Cost of installing is charged up as the cost of operating plant, is it not?

"A. No, sir; it is charged up as construction expense." (Record, p. 651.)

Therefore, taking into consideration all Mr. Smith said on this subject, which covers two or three days of examination, and the production of many vouchers, it would seem reasonably certain that the company charged against construction for many years all cost of material used in the subscribers station including the instrument, the labor for installing it, and until August, 1907, the additional sum of \$10.00 for each instrument installed.

Mr. Jagoe valued the subscribers stations at \$19.63 per station. (Record, p. 635.)

Mr. Smith said that from 1900 to 1909 inclusive the company put in 27,000 telephones and took out 20,823 telephones. (Record, p. 220.) And in many pages of Mr. Smith's deposition he deals with the credits given to construction on account of instruments taken out. I call especial attention to the record, pages 359 and 360. It would there seem that the construction account is only credited when the instrument is returned to the supply department and no credit is given either for the \$10.00 theretofore charged to construction or for the cost of material used in installing the instrument. In other words, the instrument itself when returned to the supply department is supposed to be credited by the supply department to construction account, but the other items remain a part of the construction account.

Mr. Jagoe placed a value of the instrument proper at \$11.35 (Record, p. 650), so that if it cost \$19.60 to purchase and instal each instrument, as claimed by Mr. Jagoe, then there is certainly \$8.00 for each of the 27,000 instru-

ments charged to construction, whereas there should only be charged \$8.00 per instrument on 9,300 instruments. In other words, there are now 9,300 instruments and the company during the period of ten years charged to construction account an item of \$8.00 per instrument for installing 27,000 instruments. 17,700 instruments, therefore, at \$8.00 per instrument makes a total of \$141,600.00, which should never have been charged to construction. In addition to this, from the time the company began operating up to May, 1908, a part if not all of \$10.00 per instrument on all instruments installed was without rhyme or reason, charged to construction account. What this \$10.00 item will total there is nothing in the record to show.

Smith's Exhibit No. 3 (Record, p. 476), shows that 6,800 subscribers were gained during that time, which, at \$10.00 each, would make a total of \$68,000.00 for this item alone.

Now, as to the credit given to construction when instruments are taken out. The Louisville exchange keeps on hand in its stock room a certain number of instruments. When the company is putting in more instruments than it is taking out it is constantly called upon to furnish instruments to the stock-room from its supply department. When more instruments are being taken out than are being put in, the stock-room at Louisville returns its excess instruments over the amount it usually carries to the supply department and is given credit therefor. Mr. Smith said: "Until the instrument reaches the supply department the Louisville exchange remains charged with the instrument." (Record, p. 357.) Mr. Settle said when an instrument was taken out of a subscriber's station

it was taken to the *stock-room* and when any considerable number of them were accumulated they were returned to the *supply department* and credit then given to the Louisville exchange. (Record, p. 1001.) It, therefore, seems certain that during the period from January 1, 1900, to September, 1907, during all of which time the company was gaining rather than losing subscribers, there was never any occasion to return an instrument to the supply department and, therefore, during those years no credit was given to the Louisville exchange on account of these instruments which had been charged to construction. It is moreover certain that during all of those years there were "put-ins" and "take-outs" constantly. If A had a telephone installed the cost of it was charged to construction account. If it were taken out the next month it was returned to the stock-room and no credit given to construction. If the next day the company installed it for B it would charge against construction the entire cost of installing that instrument in B's place of business. If B kept it a month and had it taken out it would be returned to the stock-room and if the next day the company installed it for C it would charge the entire cost of installing it to construction and when taken out of C's place of business would be installed in other places *ad infinitum*.

Mr. Smith's Exhibit No. 3 (Record, p. 476), shows that up to and including the year 1907, appellee put in 25,500 instruments and took out 18,500. That exhibit also shows that up to the year 1908 the company had always put in more telephones than it had taken out. Therefore, with a few exceptions where the instrument was destroyed or worn out, there could have been no credits given to con-

struction on account of these instruments being returned to the supply department.

Mr. Smith showed that during the year 1901, \$36,000.00 of material representing subscribers equipment was furnished by the supply department to the Louisville exchange and charged to the construction account. (Record, pp. 350-362.) During that year, according to Mr. Smith's Exhibit No. 3, there were 3,183 instruments put in and 1,176 taken out. For that year alone, therefore, there were over 2,000 instruments put in and charged up to construction which were not really in existence at the end of the year, and yet the cost of installing those instruments was a part of the construction account for that year.

TOLL EQUIPMENT.

There is also charged up to construction account of the Louisville exchange the cost of all toll equipment. (Record, pp. 328-331.)

TOOLS AND TEAMS.

Without going into any extended discussion of how appellee has charged to the construction of the Louisville exchange tools and teams which were purchased, I simply call attention to the following pages of Mr. Smith's deposition showing vouchers about which he testified:

Record, page 364. Mules purchased for Bardstown charged to Louisville.

Record, page 365. Mules purchased for work at Harrods Creek charged to Louisville.

Record, page 365. Mules purchased for East Tennessee Telephone Company charged to Louisville.

Record, page 371. Mules purchased for Springfield charged to Louisville.

Record, page 372. Mules purchased for Shelby County toll line charged to Louisville.

Record, page 373. Mules purchased for Springfield charged to Louisville.

Record, page 374. Mules purchased for Lexington charged to Louisville.

Record, page 370. Mules purchased for East Tennessee Telephone Company charged to Louisville.

And numerous other similar charges are to be found in the record (pages 364 to 375.)

Mr. Smith said that if a horse were sold or died the original cost of the horse would be credited to construction, and yet he produced vouchers crediting Louisville with the sale price of horses (Record, p. 431).

An examination of the vouchers above referred to and the part of Mr. Smith's deposition dealing with these vouchers illustrates very forcibly the importance of an investigation of the supply vouchers.

Items such as tools and teams are not furnished by the supply department and when the vouchers representing those purchases show such an indiscriminate manner of making charges against the Louisville exchange, then I submit it is fair to assume that the supply vouchers will be in substantially the same condition.

POLES AND WIRES.

Practically all poles and wires are furnished by the supply department and, of course, there is no way of telling whether items representing poles and wires have been

properly charged against the Louisville construction account. It, however, seems conclusive from Mr. Smith's deposition and his method of treating the credits to construction account that all items furnished the Louisville exchange by the supply department have been charged to construction account rather than distributed between construction and reconstruction.

In Mr. Smith's direct examination he went into some detail as to the method of treating the depreciation and reconstruction account.

On page 232 of the record, this question and answer will be found:

"Q. Suppose you sell the old poles and wires out of that (meaning reconstructed line) for \$1,000.00. What happens?

"A. We credit maintenance reconstruction with \$1,000.00 "

That was the proper course to pursue, but when the facts were brought out and the vouchers examined an entirely different showing was made. Mr. Smith's evidence dealing with credits to construction appears on pages 430 to 436 of the record. Without exception these credits show that the sale price of old wire and junk which was taken out of the reconstructed lines, was credited to construction.

Now, if salvage from a pole line which is reconstructed is credited to construction, I submit that there is only one excuse for it and that is because the cost of reconstructing the line is charged to construction. Any book-keeper who is going to charge to reconstruction the cost of reconstructing a pole line would certainly credit re-

construction with the salvage from the pole line so reconstructed.

Mr. Warren says that an examination of the books did not disclose a single item representing old wire or junk credited to the reconstruction account. (Record, p. 1110.)

As showing the unreliability of the appellee's books I call attention to the fact that the auditor's Exhibit No. 2 (Record, p. 475) showed that the conduit system had cost \$287,918.71.

Mr. Wilkinson, the accountant for the appellee, showed that the conduit system had cost up to 1900, when appellee acquired the plant, \$108,000.00 (Record, p. 756).

Mr. Hume, the general manager of the company, said that since the appellee had acquired the plant in 1900 it had constructed practically no conduits and had not added over 15 per cent to the conduit system since its purchase (Record, p. 695-681).

Mr. Jagoe, who placed a reconstruction value on the conduit system for the appellee, at double the cost of reproduction as fixed by the City's engineers, said that it could be reproduced new throughout for \$170,384.00 (Record, p. 624).

The above facts speak for themselves.

Taking into consideration all the foregoing facts, and I submit they are all borne out by the record, it is self-evident that no reliance can be placed in the books of the appellee in so far as reaching even a semblance of certainty as to the cost of its plant.

The Master discussed the items above mentioned and found that unquestionably there were erroneous charges

against construction. In speaking of the character of evidence offered by the appellee the Master said (Record, p. 62-63) :

"It is not clear to my mind that this is the best evidence of the correctness of such charges. I have not felt justified in rejecting such evidence, but I have carefully considered all the evidence produced which tended to discredit any and all such entries.

"The great mass of evidence, and the hundreds of detailed matters touching the correctness of charges that constitute the Construction Account, forbid any attempt to treat them singly. In fairness to both parties to this litigation, I am forced to treat these matters in a general way, and to arrive at what I consider a fair and equitable estimate of what I believe to be erroneous charges to this account."

Again the Master said (Record, p. 63) :

"Many vouchers were produced at the hearing, covering the wages of men employed in and near Louisville in connection with the aerial work, including toll lines. These vouchers show that certain wages and salaries had been expended on the aerial lines, and also on underground lines connected with the Louisville exchanges. A small proportion of these outlays was charged to Maintenance or Reconstruction, while the bulk of the outlays is charged to Construction.

* * * * *

"The evidence tends to show that in nearly every instance the wages of the employes shown in the vouchers we are considering, were charged almost wholly to Construction, and no evidence of the correctness of such charges was offered, except that the vouchers bore a notation to that effect.

"It is inconceivable that so little of these wages was properly chargeable to Maintenance or Reconstruction from 1900 to 1908. The aggregate amount of these vouchers was not shown in evidence."

Again the Master reported (Record, p. 64) :

"Vouchers from the Supply Department were called for but not produced by the company's auditor, the reason being given that he had no control over the Supply Department. (Smith's Deposition, p. 320.)

"The evidence shows that the vouchers for supplies were sent into the Nashville office from the Louisville office accompanied by a notation as to how the amounts were to be charged—whether to Maintenance, Reconstruction or Construction. But the evidence is most unsatisfactory as to whether the supplies were accurately distributed in the books of account. Vouchers from the Supply Department showed totals only, and the amounts were entered on the books in accordance with the notations of the Supply Department clerks."

Similar criticisms are made by the Master concerning the construction account on pages 62, 63, 64 and 65.

Considering all of the evidence the Master found that the plant had cost appellee \$1,381,124.41. (Record, p. 69.)

The lower Court in its opinion failed to discuss the items of cost, saying in this connection :

"The large mass of testimony directed to the subject of the cost of the plant will demonstrate the extreme difficulty of reaching a satisfactory conclusion upon the subject upon any very reliable theory."

And the Court refused to pass on the exceptions filed by appellant to that portion of the Master's report wherein he found that it had cost appellee \$1,381,124.41 to build its plant. In this connection the lower Court said (Record, p. 1624) :

"Under the circumstances we think we need not pass on those exceptions, inasmuch as whether they are sustained or overruled, the findings of the Master

as to the original cost, whether correct or not, under the circumstances of this case, furnish no very valuable guide for ascertaining the 'present value' of the plant.

* * * * *

"We think, therefore, that we may safely proceed to the consideration of the latter question without directly passing upon the exceptions to the Master's findings as to the former, though we incline to think that the testimony clearly shows that the original cost of the company's plant, exclusive of real estate and franchise, was as much as \$1,600,000 beyond any premium paid for stock in the Ohio Valley Telephone Company."

The lower Court, therefore, did not sustain the exceptions to the Master's report in this respect, which, therefore, leaves the Master's report affirmed to the extent of finding that the plant had cost the appellee \$1,381,124.41.

Had the Master actually found that appellee paid \$1,600,000.00 for its plant "exclusive of franchise and premium paid for stock in the Ohio Valley Telephone Company" it would be a very simple matter to show the inaccuracy of such a finding. The franchise appeared on the balance sheet of the Ohio Valley Company as \$100,000.00. (Record, p. 1326.) The Master found that appellee paid \$145,000.00 premium on the stock of the Ohio Valley Telephone Company. These two items added to the \$1,600,000.00 makes a total of \$1,845,000.00 which the Court *thought* appellee paid for its plant, whereas, appellee only contended in its Bill of Complaint that its plant had cost \$1,700,000.00 (Record, p. 13). Appellee, however, contends that instead of paying only \$145,000.00 premium for the stock of the Ohio Valley Telephone Company, it paid \$145,000.00, plus \$79,000.00, plus \$135,000.00. (Record, p. 756.) If these two sums are accepted, the cost

of appellee's plant according to the Court will be still further enhanced.

In connection with expenditures which have been charged as the cost of constructing the Louisville exchange, I now call attention to certain portions of the record which show that the earnings of the Louisville exchange have been invested in the plant. That is to say, the record shows that the expenditures for constructing the Louisville exchange have been paid in part out of its earnings. The amount so expended does not appear in the record, and if the rule adopted in the case of *Railroad Commission vs. Cumberland Telephone & Telegraph Company*, 212 U. S. 419, is to be applied, then the judgment of the lower Court must be reversed.

It will be remembered that in the Louisiana case Mr. Smith and Mr. Caldwell said that appellee had set aside 7 1-2 per cent per year to take care of incomplete depreciation; that this 7 1-2 per cent had been placed in the general treasury of the company, and that all of it had not been expended in reconstruction work; that the unexpended part had been used in transacting the business of the company and in enlarging its plant over its system generally. (See Transcript of Record, Case No. 182, October Term, 1908, *Railroad Commission vs. Cumberland Telephone & Telegraph Company*, pp. 54-65-169.)

The Railroad Commission contended that the appellee could not be permitted to earn a dividend on any portion of its plant which had been constructed out of earnings on the Louisiana business. The lower Court held that it was incumbent on the *Railroad Commission* to show exactly how much of the depreciation fund had been invested in the plant. This Court held, however (Mr. Justice Peck-

ham delivering the opinion), that the lower Court was in error in this respect, that if appellee had invested any of its Louisiana earnings in the Louisiana plant, then it could not be allowed to earn a dividend thereon, and that it was incumbent on the appellee to show exactly how much of its plant investment was derived from earnings on Louisiana business. In this connection this Court said:

"It certainly was not proper for the complainant to take the money, or any portion of it, which it received as a result of the rates under which it was operating, and so to use it, or any part of it, as to permit the company to add it to its capital account, upon which it was paying dividends to shareholders. If that were allowable, it would be collecting money to pay for depreciation of the property, and, having collected it, to use it in another way, upon which the complainant would obtain a return and distribute it to its stockholders."

And so this Court held:

"Now, although the books, it is said, do not show how much money collected for depreciation has been, in fact, used to increase the capital of the complainant, upon which dividends were paid to stockholders, yet still, even if the books do not show accurately, or even at all, what disposition was made of these moneys, at any rate the officers of the complainant must be able to make up some reasonable approximation of the amount, even if it be impossible to state it with entire accuracy; and this duty rests with the complainant, in order that it may discharge the duty devolving upon it to prove that the rates were not unreasonably high."

Appellee in this case has tried a different tack from that tried in the case above referred to. It does not propose to break on that particular rock, and yet I think I can show by the evidence that it has foundered at identically

the same place, and that this record shows identically the same situation as that shown in the Louisiana case.

Mr. Smith, the auditor of the company, was the first witness to testify. On pages 229 to 235 will be found Mr. Smith's labored attempt to explain depreciation and appellee's method of treating it. Mr. Smith concludes what he has to say on page 235 as follows:

"Q. Now, I will ask you whether or not the company has set aside for Louisville, and if so how much, of a depreciation fund unexpended?

"A. The company never earned enough money in Louisville to set aside any fund."

Mr. Caldwell, the president of the company, also said that the company had never set aside any amount to take care of depreciation. (Record, p. 840.)

Mr. Hume, the general manager, did not testify in chief, but was called to rebut the testimony of the City's engineers. His deposition is remarkable as concerns depreciation. A part of his deposition was taken on March 18, 1910, and it was concluded on March 19. On the first day he testified as follows (Record, p. 680):

"Q. Now taking up first the question of depreciation, how much does the Cumberland Telephone & Telegraph Company set aside to take care of depreciation?

"A. Seven and one-half per cent."

Again, on page 685, in answer to a question asked by the Master he testified as follows:

"Q. Mr. Hume, since the Ohio Valley Telephone Company plant was obtained, it has been about ten years?

"A. Yes, sir; about ten years.

"Q. Now in that time, as I understand, you have constantly set aside as a depreciation fund seven and one-half per cent?

"A. Yes, sir."

The next morning he answered a question concerning depreciation as follows (Record, p. 698) :

"Of course, if seven and a half per cent is not available from earnings to set apart it cannot be set apart, and is not set apart, and unfortunately this has been the condition at Louisville."

On the first day Mr. Hume evidently had in mind the testimony he had given in the New Orleans Rate Case and did not know the legal significance of what he said concerning the company setting aside a depreciation fund. Over night he seems to have seen a great light.

As to the disposition made of the earnings of the Louisville exchange, I call attention to the following parts of the record. Mr. Smith said :

"As the depreciation is invested in plant, when you need the money to construct a part of the plant, you cannot sell any part of the plant to get that money, and therefore we get the money from capital. We re-pay the depreciation fund from capital.

"Q. So, if you put the money in your treasury and and do not use it, you must use a higher per cent than seven and one-half per cent for depreciation?

"A. Yes.

"Q. And, in order to get along on seven and a half per cent, you must use that unexpended portion of it in your business?

"A. Yes.

"By the Commissioner :

"Suppose that depreciation account is a mere credit on your books and you allow it interest. Now, suppose the time comes when you need that amount, plus the interest, where do you get it? You say

you take it from capital, that is what I didn't understand.

"A. We would have to borrow money on notes, or issue stocks or bonds in order to get the amount of money we need.

"Q. You don't do that, however,—you don't add that to the value of your plant. You don't make any increase in the value of your plant, on your books, do you?

"A. We do. Any amount of money that is expended, any additions or improvements in the plant, is added to plant, and if we did not do that and add it to plant, we would not make it earn any money." (Record, pp. 229, 230.)

Again Mr. Smith testified as follows:

"Q. From what source was the money derived which was expended and charged to construction account of the Louisville exchange?

"A. The money was all paid out of the treasury of the company. The larger part by far of all the construction which has been done throughout the whole of the company's system has been derived from the sale of its stock at par. There were no appropriations of money from specific sums for the construction of the Louisville exchange but think the money practically all came from its stock.

"Q. Where was the money placed which was derived from the sale of the stock?

"A. In the treasury of the company.

"Q. Where were the earnings from the Louisville exchange placed?

"A. In the treasury of the company, if there were any.

"Q. And was this money which was expended for construction account in Louisville paid out of the same treasury into which the proceeds of the sale of stock and the earnings were put into?

"A. Yes, but accounts were kept so that the earnings are known, if there were any." (Record, pp. 383-384.)

Again Mr. Smith said:

"Q. What have become of your earnings from the Louisville exchange?

"A. Whatever net earnings there were—and there has been precious little—have been placed in the general treasury.

"Q. Has any of it been set aside for a depreciation fund to take care of the Louisville plant when it ceases to be in operating condition?

"A. Not specifically.

"Q. Has any of it been used to pay dividends?

"A. Not specifically.

"Q. What has become of it?

"A. It has been placed in the general treasury of the company.

"Q. Are the earnings from the Louisville exchange sent direct to Nashville, or are they kept in Louisville and vouchers and payrolls paid out of those earnings?

"A. The gross earnings are remitted in toto to the treasurer at Nashville.

* * * * *

"If I understand you, then, Mr. Smith, all the earnings from the Louisville exchange are paid into the general treasury. That is correct, is it?

"The gross earnings, yes, that is a fact, all over the territory.

"Q. And no part of the earnings from the Louisville exchange have been set aside to take care of depreciation?

"A. The earnings have been so scant at Louisville that we have not been able to specifically set aside anything.

"Q. Have the expenses of operating the Louisville exchange been paid out of the general treasury?

"A. All expenditures for the benefit of the Louisville exchange have been paid out of the general treasury.

"Q. Then the difference between the gross earnings and the expenditures of conducting the Louis-

ville exchange have remained in the general treasury until they have been used for some other purpose, have they?

"A. Yes." (Record, pp. 389-390.)

Mr. Caldwell had this to say on the subject:

"Q. Now, speaking of the depreciation fund which you say is a part of your operations. What is done with the depreciation fund?

"A. Well, sir, I don't think there has been anything done with it in Louisville, for we have not made enough money to set aside any depreciation fund there.

"Q. What is done with it generally?

"A. It is preserved for the care of the property.

"Q. In what is it invested?

"A. It is invested in cash and supplies and working capital.

"Q. Invested in the plant?

"A. Invested in cash, and supplies and working capital.

"Q. Cash, supplies, etc., are placed in the plant?

"A. Cash is kept in the treasurer's drawer and in bank, and supplies are kept in the warehouse and when they are drawn from, and that put into the plant, they are charged to it." (Record, pp. 549-550.)

Here is Mr. Hume's remarkable testimony on the subject:

"Q. Now taking up first the question of depreciation, how much does the Cumberland Telephone and Telegraph Company set aside to take care of depreciation?

"A. Seven and one-half per cent." (Record, p. 680.)

The Master:

"Q. Mr. Hume, since the Ohio Valley Telephone Company plant was obtained, it has been about ten years?

"A. Yes, sir; about ten years.

"Q. Now in that time, as I understand, you have constantly set aside as a depreciation fund, seven and one-half per cent?

"A. Yes, sir." (Record, p. 685.)

Again he said :

"Of course if seven and a half per cent is not available from earnings to set apart it cannot be set apart, and is not set apart, and unfortunately this has been the condition at Louisville." (Record, p. 698.)

The foregoing facts, considered in the light of the Louisiana case, makes it apparent that the gross receipts of the appellee from the Louisville exchange are paid into the treasury of the company; that the expenses of the Louisville exchange are paid out of the treasury; that the costs of constructing the plant is paid out of the treasury, and that a part of the earnings of the exchange, if there have been any earnings (see Note), have necessarily been expended in constructing the Louisville plant. Appellee has not shown how much of these earnings have been so expended, and as it cannot under the law earn a dividend on that portion of its plant which has been constructed out of earnings, the decree should be reversed.

VALUE OF PLANT.

In his report (Record, p. 70) the Master found

the value of the plant to be	\$1,243,011.97
Value of toll lines and equipment	112,866.12
<hr/>	
Total value of exchange plant and toll lines, not including real estate	\$1,355,878.09

NOTE. The question of whether or not appellee has earned money is discussed in this brief (pp. 198-99), where it is shown that for the year 1900 the company earned 19 per cent on the value of the plant, for the year 1901 it earned 15 per cent and for the years 1905, 1906, 1907 and 1908 it earned from 6 to 12 per cent. (See this brief pp. 201, Rec. p. 85.)

The Master's finding on the subject of the value of the plant was arrived at after hearing and seeing the witnesses testify, and carefully considering all the evidence in the case; and unless there is abundant proof showing that the Master was in error, we assume his finding should not be set aside.

Appellee's counsel in the lower Court accepted the Master's finding of fact as to value provided the Court would add thereto a sum representing the following four items of value which it contended the Master did not include, namely:

Value of franchise.

Value of going concern.

Value of supplies.

Working capital.

We will first discuss the value of the plant as found by the Master, together with his reasons for so finding, and will then proceed to discuss the four items above mentioned, to-wit: franchise, going concern, supplies and working capital.

In discussing the value of the plant the following parts of the record are pertinent and were considered by the Master:

Jagoe's deposition.

Polk's two depositions.

Crumb's deposition.

Leving's deposition.

Mr. Caldwell, the president of appellee company, thought the property was worth what it cost. (Record, p. 501.)

Mr. Smith, the auditor of appellee company, thought the property was worth what it cost. (Record, p. 221.)

Mr. Hume, general manager, thought that Mr. Jagoe's statement showing a value something in excess of \$1,700,000.00 was correct. (Record, p. 670.)

Mr. Jagoe went into detail showing of what the plant consisted, and what it would cost to reproduce its various parts. *(No inventory 640-1-8-653-663)*

The deposition of Mr. Jagoe should be read in connection with Mr. Polk's second deposition inasmuch as the items of cost named by Mr. Jagoe were discussed by Mr. Polk.

In arriving at the weight that should be given the respective depositions of Mr. Jagoe and Mr. Polk it should be borne in mind that Mr. Jagoe constructed no part of the Louisville plant; that he had had no experience in constructing a telephone plant, or any parts of a telephone plant in Louisville, or elsewhere (Record, p. 641); whereas Mr. Polk had constructed complete telephone plants in Louisville and in many other cities.

Mr. Jagoe (Record, p. 622) said that his duties were to supervise construction and to "advise with the engineering department on all proposed work." There is no telling what he meant by this, but I assume he would have stated what plants he had constructed had he ever constructed any. He certainly was not a telephone engineer, and he admitted he had nothing to do with constructing the Louisville plant. (Record, p. 641.)

Mr. Polk, Mr. Crumb and Mr. Levings all testified for the City and detailed the extent of the experience which they had had in constructing telephone plants, stating city after city in which they had constructed such plants.

Mr. Polk, for instance, said that he was graduated as a civil engineer in the Ohio State University, and that,

"for 14 or 15 years my duties have been entirely in connection with construction work on telephone plants." (Record, p. 1492.) He said that he was employed by the Central Union Telephone Company, a Bell Telephone Company, for six years and in that connection constructed telephone plants in Columbus, Toledo, Akron, Canton, Dayton, Springfield and Zanesville, Ohio; Indianapolis, Terre Haute, Munsey, Anderson and Fort Wayne, Indiana; Rockford and Springfield, Illinois; that for the last eight years he has been engaged in constructing telephone plants for Independent Telephone Companies at Toledo, O.; Louisville, Ky.; Kansas City, Mo.; Utica, N. Y.; Mobile, Ala.; and numerous other places. He said that he spent eighteen months in Louisville, and had entire charge of constructing the Louisville Home Telephone plant; that he purchased all of the material for the plant, employed all the labor and knew exactly what it cost to construct a telephone plant such as the Cumberland plant in the City of Louisville; that this work was done in 1901 and 1902; that he was at that time familiar with the plant of the Cumberland Company and the character of its construction. (Record, p. 1493.) He said that he inspected the plant of the Cumberland Company shortly before giving his deposition; that he ascertained from the blue prints furnished by the company the exact extent of the conduit and cable system; that he inspected the switchboards and knew the number of instruments installed in subscribers' stations. The only three items on which his valuation is an estimate are the poles, the wire on the poles, (not including cables), and the tools and teams. He said he actually knew what it cost to construct conduits such as the appellee has, that he actually knew what it

cost to purchase the character of cable which the appellee uses, that he had actually purchased such cable, as well as the smaller items such as messenger wire, guy wire, etc., that he had actually constructed such cables in the City of Louisville, and various other places and knew exactly what it cost to purchase cable and what it cost to string it in the City of Louisville. (Record, p. 1391.)

Mr. Polk and Mr. Jagoe do not vary as to the amount or character of conduits in the system; they do not vary as to the amount or character of cable in the system; they do not vary as to the amount of equipment. They do vary as to the cost of reproducing all of the above items. They vary as to the number of poles and the amount of wire; and also as to the amount and cost of the wire and the poles.

The extent of the conduits and cables in the system is shown by blue prints which were filed by Mr. Crumb with his deposition, and Mr. Jagoe said that his figures were based on these blue prints and that the blue prints show the amount of material in the plant. (Record, pages 628, 629, 641, 654.)

Counsel for appellee at the argument below said very frankly that he had the highest opinion of Mr. Polk's integrity, ability and intelligence.

Mr. Jagoe, (p. 635), and Mr. Polk, (p. 1411), put the following valuation on the plant:

	Jagoe.	Polk.
Conduit	\$ 170,676.96	\$ 95,082.00
Aerial cable	431,955.35	241,351.00
Aerial wire	77,035.87	52,000.00
Poles	331,769.40	176,000.00
Switchboard	309,102.92	203,000.00
Subscribers' stations	184,465.15	128,755.00
Underground cable	288,942.50	189,549.00
Miscellaneous supplies on hand		18,000.00
Furniture and fixtures		2,000.00
Taxes, rent and insurance ...		5,000.00
Soliciting and right of way..		15,000.00
Engineering and supervision,		20,000.00
General Legal Miscellaneous,		50,000.00
Total	\$1,793,948.15	\$1,195,737.00

Mr. Crumb (Record, pp. 876 to 887) placed the following valuation on the plant:

Conduits	\$ 100,000.00
Aerial cable	225,000.00
Aerial wire and poles	150,000.00
Switchboards	200,000.00
Subscribers' stations	100,000.00
Underground cable	200,000.00
Tools, teams and furniture	20,000.00
Supplies and working capital	20,000.00
Total	\$1,615,000.00

Mr. Levings (Record, pp. 1526 to 1528) placed a valuation on the entire plant of \$1,000,000.00.

Based on the unit of values found by Mr. Jackson, who valued the Boston plant, and placed a valuation thereon of \$92.00 per station (Record, p. 660), the Louisville plant would be valued at \$864,340.00, (it having 9,395 stations or subscribers).

The Chicago Commission valued the Chicago Bell Telephone Company at \$100.00 per station. (See Record, p. 891.) On the same basis the Louisville plant would be valued at \$939,500.00.

The witnesses who testified concerning the value of the telephone plant distributed the parts of the plant under the following headings:

Cables.

Aerial Wire.

Poles.

Switchboards.

Subscribers' Equipment.

Conduits.

I will, therefore, discuss the various parts of the plant in the above order:

CABLES.

Mr. Jagoe valued the cable as follows:

Aerial cable	\$431,955.35
Underground cable	288,942.50

Mr. Polk valued the cable as follows:

Aerial cable	\$241,351.00
Underground cable	189,549.00

Mr. Crumb valued the cable as follows:

Aerial cable	\$225,000.00
Underground cable	200,000.00

Cables are placed in the conduits and also on poles. They are strands of copper wire encased in a lead sheath. They are used indiscriminately underground and overhead. There are different gauges of these wires running from 19 to 22. 19 gauge wire has more copper in it and costs more money. There are also different sizes of cables. For every subscriber there must be a pair of wires. Some of the cables contain 25 pairs, some 50, some 100, some 200 and some 400 pairs of wire. The size of the cable also has something to do with its cost. On page 1389 of the record will be found the values placed by Mr. Jagoe on various kinds of wire in the underground cable and on page 1390 will be found the corresponding values placed by Mr. Polk. The amounts do not greatly vary, but the prices materially vary. For instance, Mr. Jagoe is lower than Mr. Polk on items 1, 2, 4 and 9. These are all small items and the difference in dollars is small. However, on items 3, 6 and 8 which are large items, Mr. Jagoe is considerably higher than Mr. Polk. Here is a table showing the values placed by the two witnesses:

Jagoe. (p. 1389)

Underground Cable.

Pr.	Gauge.	Cts.	Dollars.
25	22	11	202
50	22	17	470
50	19	27	14,649
100	22	29	848
100	20	40	457
100	19	52	67,677
200	22	55	4,666
200	20	70	39,097
400	22	93	46,756
Wool cable			7,950

 \$182,772

Installing,
 Splicing,
 Supervising,
 etc., 106,167

 \$288,939

If 100 pairs 20 and 22 gauge is correct, then 19 gauge should be 45½ cts., whereas Jagoe fixed it at 52 cts.

Mr. Jagoe said that the prices given by him were current prices. (page 648). Mr. Polk said that he knew the prices; that he had bought cable right along for years, had the price lists sent to him constantly, and knew that the prices named by him were prices at which cable could be purchased and delivered in Louisville. (Record, p. 1393.)

Mr. Polk explained (Record, pages 1392 to 1396) how

Polk. (p. 1390)

Underground Cable.

Pr.	Gauge.	Cts.	Dollars.
25	22	12	223
50	22	20	387
50	19	24	9,527
100	22	31	341
100	20	38	417
100	19	43	56,006
200	22	52	5,185
200	20	68	39,781
400	22	96	50,748

 \$162,615

9 cts. per foot
 for Installing,
 etc. 26,934

 \$189,549

Cable boxes ... 3,000
 Protectors 1,400

 \$193,949

If 100 pairs 20 and 22 gauge is correct, then 19 gauge should be 41½ cts., whereas Polk fixed it at 43 cts.

Mr. Jagoe's figures were inconsistent and necessarily not reliable. For instance, there is not the same proportionate relation between 100 pairs of 19 gauge and 100 pairs of 20 gauge that there is between 100 pairs of 20 gauge and 100 pairs of 22 gauge. If Mr. Jagoe's figures as to 100 pairs of 20 and 22 gauge are correct, then his figures on 100 pairs of 19 gauge are necessarily too high.

There is practically no difference between Mr. Jagoe and Mr. Polk on the cost of cable except as to the 19 gauge cable. Mr. Polk's valuation on 19 gauge is proportionately the same as the price placed by him on the 20 and 22 gauge cable, whereas Mr. Jagoe placed a value on the 19 gauge cable out of all proportion to the price fixed on 20 and 22 gauge cable.

Mr. Jagoe itemized the various articles necessary to install cable. Of this Mr. Polk (Record, p. 1391) said:

"Q. 32. Mr. Jagoe also mentioned splicing, lead sleeve, wiping solder, boxes with protectors, pot heads, labor of pulling in cable, laying out pairs of main frames, paraffine, paper sleeves, etc. What have you to say in regard to those items, have you placed any value on those various items? If so, how did you arrive at the value you placed on the items covered by those?

"A. I know from past experience, how much it cost to install cables per foot, and I figured my cost at so much per foot as installation, and did not go into these various materials used in installation.

"Q. 33. Which is the customary method of reaching the cost of installing an underground cable system, the method you pursued or the method Mr. Jagoe pursued?

"A. The method I pursued at so much per foot for laying the cable.

"Q. 34. Why is that?

"A. Because its cost does not vary materially in various systems.

"Q. 35. Under what circumstances would the itemized bill of material such as Mr. Jagoe has used become necessary?

"A. It only becomes necessary when it becomes necessary to place the order for material. In making the estimate, those items are not considered at all.

"Q. 36. What do you say is the value of installing the cable system including these various items you have mentioned here, and also freight, if there is freight?

"A. I include my freight in the cost of cable, which is the proper way, as cable is practically always purchased, delivered or with a freight allowance.

"Q. 37. Answer the balance of my question.

"A. I allow nine cents per linear foot for installation of cable.

"Q. 38. How much does that amount to in dollars?

"A. That makes a total cost of the underground cable system \$189,549.

"Q. 39. Is nine cents per foot a sufficient amount to cover all those items?

"A. *It is a very liberal, as I know that the Western Electric Co. which has taken several contracts for installation of cables for the Bell Telephone Co. has done so often at seven cents a foot.*"

Mr. Jagoe made a great point of the fact that in valuing cable he took the average price over a period of eight years. But on page 648 Mr. Jagoe gave this evidence:

"Q. How does the price now compare with the average price?

"A. It is very close to the same. There has been very little change in the market price now, as compared to that."

Mr. Smith's exhibit No. 2 (Record, p. 475) shows that fully 85 per cent of the cable was installed prior to 1905, and Mr. Polk stated (pages 1446-1447) that prices were lower prior to 1905 than they were in 1909.

Mr. Jagoe after putting a high price on the cables added an item of \$147,065.00 for supervision. (Record, pp. 643-644).

Aerial and underground cable cost the same. (Record, p. 1391).

Mr. Polk showed (Record, p. 1395) the amount of cable which appears on the blue prints with no description as to its gauge and in some instances as to its size, and explained what valuation he placed on this part of the cable. He told why he placed certain values on this cable.

Mr. Polk also showed how much dead cable there is in the system, namely, 31,242 feet. (Record, p. 1398).

He showed that a considerable part of the cable appearing on the map is marked proposed plans for cable, and he also showed (Record, page 1398) that he went along one route which was marked "proposed plan" and found no such cable in existence. With the exception of this particular route he included in his valuation all the cable that appeared on the blue print whether it was marked dead cable or proposed cable.

He showed that the cable system had 21,200 cable pairs entering the four exchange offices, and showed that according to Mr. Jagoe there were only 5800 pairs being used. (Record p. 1398.) It therefore, necessarily appears that there are 15,400 pairs of wire within these cables which are not being used. This is almost three times as much as is actually in use. Mr. Polk said that when a company had

5800 pairs in use it should have 8000 or 9000 pairs constructed in order to take care of the anticipated business. In other words, that if a company installs a plant to begin with 5,800 pairs it should have 8,000 pairs of wires connected at the beginning. It is therefore, certain that over two-thirds of the cable in the system is not in use. Mr. Polk desiring to be more than liberal, said that certainly 35 to 40 per cent was useless in its then condition and should never have been constructed. (See Record, p. 1399). If 35 per cent of the cable be deducted from the value of the cable as found by Mr. Polk, it will appear that his valuation of the plant will be \$1,045,000.00 instead of \$1,195,000.00. If 35 per cent of this cable be deducted from what Mr. Jagoe placed as the value of the cable, namely: \$720,000.00. it will mean a deduction of over \$250,000. from his figures, leaving his total valuation at \$1,543,000.00, instead of \$1,793,000.00. It will be remembered, however, that in Mr. Jagoe's valuation of \$1,793,000.00 there is \$206,000.00 which represents overhead charges and which overhead charges the lower Court said could not be considered in arriving at the value of the plant. (See this brief, p. 33). Therefore, on this basis Mr. Jagoe, the only witness for the appellee who placed a reproduction value on the plant, is on record as saying that the plant could be reproduced for \$1,340,000.00. whereas the Court found that the plant was worth \$1,788,000.00.

In this connection we call the Court's attention to the case of Spring Valley Water Company vs. San Francisco, 165 Fed., 697, where the Court said:

"It is not just to compel consumers to pay for more than they receive, or to pay complainant an income on

property which it not actually used in gathering and furnishing water."

In the case of *San Diego L. & T. Co. vs. Jasper*, 189 U. S. 429, Justice Holmes, of this Court, said:

"If a plant is built, as probably this was, for a larger area than it finds itself able to supply, or apart from that, if it does not yet have the customers contemplated, neither justice nor the Constitution requires that, say, two-thirds of the contemplated number should pay a full return."

In *Water District vs. Water Co.*, 99 Me., 376, S. C. 59 Atl. 539, the Supreme Court of Maine used this language:

"Suppose that a five-hundred horse power engine was used for pumping when a one-hundred horse power engine would do as well. As property to be fairly valued, the larger engine might be more valuable than the smaller one, yet it could not be said that it would be reasonable to compel the public to pay rates based upon the value of the unnecessarily expensive engine."

Now, when we come to compare Mr. Jagoe's costs of replacing the cable with Mr. Smith's statement of what it cost to construct this cable, we find the following facts:

Mr. Smith's Exhibit No. 2 (Record, p. 475) shows that the aerial construction after adding the excess valuation on the Ohio Valley up to January 1, 1909 cost the company \$832,364.43. This item includes all of the cables, all of the poles, and all of the wire. Mr. Jagoe has the following figures representing the same items:

Poles	\$331,760.00
Aerial & underground cable....	720,897.85
Aerial wire.....	77,035.87

Total\$1,129,693.72

In other words, after all the excessive charges made against construction as has been shown, Mr. Smith said that the aerial construction cost the company only \$832,000.00 whereas Mr. Jagoe said it would cost \$200,000.00 more to reproduce it. This showing should be a sufficient refutation of Mr. Jagoe's figures.

Reference was made in Mr. Jagoe's deposition to the report of Mr. Jackson to the Highway Commission of Massachusetts. We have, therefore, prepared a table showing the value placed by Mr. Jackson, and the value placed by Mr. Jagoe on the cable. Mr. Jagoe, (p. 635), said that there were 40,000 miles of cable used in connection with the Louisville exchange and 9,325 subscribers. Mr. Jackson said there were 200,000 subscribers to the Massachusetts exchange, and 452,000 miles of cable. This table is as follows:

Jagoe, 40,000 miles, \$18.00 per mile,—\$720,000.—\$72 per subscriber.

Jackson, 452,000 miles, \$13.50 per mile, \$6,100,000., \$30 per subscriber.

In other words, if Mr. Jagoe's figures are to be accepted, then it means that the complainant has invested in its Louisville plant in the way of cable \$72.00 for every subscriber it has, whereas Mr. Jackson said that in Massachusetts the Bell Company had invested in its cables only \$30 for every subscriber.

Mr. Jagoe admits (p. 660) that Mr. Jackson found the Boston Exchange only cost in its entirety \$92.00 per subscriber.

There is also in this record the report of the Chicago Telephone Commission of the City of Chicago which has

figured frequently in the deposition and in the argument below. I have prepared a table showing the percentage which the cable bears to the total plant as shown by Mr. Jagoe, Mr. Polk and Mr. Jackson and by the Chicago report. I have based the percentage of Mr. Jagoe and Mr. Polk on the value of the plant as found by the Master, namely \$1,243,000. That table is as follows:

Mr. Jagoe	58 per cent.
Mr. Polk	35 per cent.
Chicago report	30 per cent.
Mr. Jackson	20 per cent.

AERIAL WIRE.

Mr. Jagoe valued the aerial wire as follows:

5528 miles of aerial wire\$77,035.87

Mr. Polk valued it as follows:

3500 miles of aerial wire\$52,000.00

Aerial wire means separate strands of wire on poles. In other words, wire not encased in cables.

Both Mr. Jagoe and Mr. Polk estimated the amount of wire (Jagoe, Record p. 653), Polk, (Record p. 1404), it being impossible to measure it.

As to the character of wire, there is practically no difference between them. Mr. Jagoe claimed there was some No. 12 wire, but Mr. Polk showed (pages 1400-1402) that there was nothing but No. 14 wire in use by the appellee.

Mr. Jagoe said there were 5548 miles of this wire and Mr. Polk said there was only 3500 miles of wire.

No material difference was made in the value of the wire. In fact Mr. Jagoe placed a value of \$14.00 per mile, whereas Mr. Polk placed a value of almost \$15.00 per mile.

The only difference was in the number of miles. Both Mr. Jagoe and Mr. Polk based their estimate of the amount of wire on the number of poles which they said were in the plant, and the variation between them as to the number of poles, (which will be discussed later) is the occasion for the difference between them as to the gross amount of wire.

Below is a table showing the number of miles and the value and amount of wire per subscriber as shown by Mr. Jagoe, Mr. Jackson and Mr. Polk:

Jagoe: 5548 miles—9300 subscribers—3.5 miles of wire per subscriber.

Jackson: 67000 miles—200,000 subscribers—1.3 mile of wire per subscriber.

Polk: 3500 miles—9300 subscribers—1.3 mile of wire per subscriber.

It, therefore, seems that Mr. Polk and Mr. Jackson agree on the amount of wire necessary for each subscriber in a telephone exchange, whereas, Mr. Jagoe says a great deal more is necessary.

POLES.

Mr. Jagoe valued the poles as follows:

13870 poles, \$23.92 each\$331,759.40

Mr. Polk valued the poles as follows:

11000 poles, \$16.00 each\$176,000.00

Poles are used in all sections of the City except where the wires are in conduits.

Mr. Jagoe (Record, p. 654) said he caused the poles to be counted; that he did not count them himself. Mr. Green said he counted the poles.

Mr. Jagoe, (Record, p. 654) said there were 9787 poles in the City and 4000 in the country.

Mr. Polk said there were 10,000 in the City and 1,000 in the country. There is, therefore, practically no difference between the two witnesses as to the number of poles in the City. The only difference is in the number of poles in the country.

Mr. Smith's Exhibit No. 6 shows that there are only 303 subscribers to the exchange outside of the City limits. (See Record, p. 1103). If 9700 poles are sufficient to accommodate 9000 subscribers in the City certainly it would seem that 4000 poles would be out of all reason for the accommodation of 300 subscribers outside of the City.

Mr. Polk said that 4,000 poles in the country to serve 300 subscribers could not represent the facts. (Record, p. 1399).

As to the value of poles we simply have the statements of the two men.

Mr. Jagoe said it cost \$23.92 to put them in position. Mr. Polk said he had constructed a plant in Louisville with many thousands of telephone poles, that they were practically the same character of poles; that he knew what he was talking about when he spoke of purchasing and erecting poles, and that the poles of the appellee could be reproduced at a cost of \$16.00 per pole.

Mr. Jagoe talked a great deal about certain creosoted poles which he thought were of considerable value. He named the location of some of these creosoted pole routes. Mr. Polk said that he went to the locations mentioned by Mr. Jagoe and found no creosoted poles at all. (Record, p. 1450).

Mr. Polk said creosoted poles cost about the same as chestnut poles, (the kind used in the Home Telephone plant,) and gave reasons for his statement. He went into detail as to when and how he purchased such poles and spoke of having invoices representing the purchase of such poles. (Record, p. 1450).

Mr. Polk's deposition was adjourned over one night and Mr. Granbery in a conversation with him at the Seelbach Hotel, remarked that Mr. Polk was in error about the creosoted poles and that he (Mr. Granbery) would have a witness to produce vouchers showing the purchase of creosoted poles at the price indicated by Mr. Jagoe.

The next morning, when Mr. Polk resumed the stand, (page 1450) and was again asked about these creosoted poles and about this conversation, and he stated that he knew what he was talking about, that he had sent to the Mobile Telephone Company, of Mobile, Ala., which he constructed, and obtained from them the invoice representing the purchase of creosoted poles 40 feet in length, of the highest grade, that he had this invoice and that it would be produced and filed if necessary.

Complainant thereafter took other depositions, but no witness was asked in regard to the value of creosoted poles.

There is some evidence in the record dealing with the price actually paid by the complainant for poles, some of them 40 feet in length, many of them 33 feet in length. This evidence came out with the production of vouchers by Mr. Smith, the Auditor. *These vouchers show that the company paid only from one to two dollars per pole.* (See Record pages 279, 290).

Again, we have prepared a table based on what Mr. Jagoe, Mr. Jackson and Mr. Polk said as to the value of

poles. Mr. Jagoe said that there were 13,870 poles on which he placed a value of \$23.92 each. Mr. Polk said that there were only 11,000 poles on which he placed a value of \$16.00 each. The table is as follows:

Jagoe: 13,870 poles at \$23.92 each	\$ 331,700.00
Jackson: 310,000 poles at \$13.50 each	\$4,260,000.00
Polk: 11,000 poles at \$16.00 each	\$ 176,000.00

That is to say, Mr. Jagoe said that it cost \$23.92 each to reproduce the poles as they were whereas Mr. Jackson said it would cost only \$13.50, and Mr. Polk said it would cost \$16.00 per pole.

Again, when we consider the percentage of pole lines to the entire plant, we find that basing the calculation on the Master's valuation of the plant, namely, \$1,243,000.00. Mr. Jagoe's valuation will show that the pole lines represent 25 per cent of the entire cost of the plant.

Mr. Polk's valuation shows that the pole lines represent 13 per cent of the entire valuation.

Mr. Jackson's report shows that the pole lines represent 14 per cent of the entire valuation.

Mr. Crumb, speaking of the number of poles, said that experience among telephone engineers had shown, "that the number of poles employed in the construction of a telephone exchange bears a very close relation to the number of stations in that exchange." (Record, p. 886).

The facts as brought out by Mr. Jagoe's count and Mr. Polk's estimate establish this proposition. Mr. Jagoe said that with 9395 subscribers there were 9870 poles.

Mr. Jagoe said that 4,000 poles were needed in the country to take care of 300 subscribers. If this state-

ment is correct, it means that to accommodate 300 subscribers in the county, the Louisville exchange has gone to the following expense:

4,000 poles at \$23.92 each	\$95,680.00
4-13 of the aerial wire	23,700.00
300 subscribers' stations at \$19.63 each	5,889.00
Switchboards for 300 subscribers at \$33.00 each	9,900.00
Total	\$134,169.00

Of course, poles, cables and conduits are used to carry these wires to the exchange after they get inside the City Limits. Also according to Mr. Jagoe, supervision should be added.

If the above valuation is correct then appellee has invested the sum of \$447.00 on each of its country subscribers. The entire plant in Boston, according to Mr. Jackson, cost only \$92.00 per subscriber.

As the country subscribers are connected with the Louisville exchange, the appellee, the accountants, the Master and the lower Court all treated the receipts of country subscribers as exchange earnings; the expenses of maintaining country lines being charged as expenses of the exchange. Likewise the investment in the country lines has not been separated from the investment inside the City limits. The City, however, has the right to demand a separation of these items. Its rates cannot be declared confiscatory because of losses sustained by appellee on subscribers outside of the City limits. If, therefore, appellee's valuation on its property outside the City limits is to be accepted, then the City insists on eliminating from

consideration every item bearing on the country subscribers including the 4,000 poles, the wire on those poles, and every other item of value. The contention of the City in this respect is upheld in the Knoxville Water Case.

SWITCH BOARDS.

Mr. Jagoe valued the switch boards at: \$309,102.92.

Mr. Polk valued the switch boards at: \$203,000.00.

Mr. Crumb valued the switch boards at \$200,000.00.

Switch boards represent the apparatus inside of the four exchanges, Main, East, South and West, by means of which subscribers communicate with each other.

The Western Electric Company, as shown by the vouchers produced by Mr. Smith, installed all of the switch boards.

Mr. Jagoe made no pretense of knowing the value of that equipment. He based his valuation on the invoices. (Record, p. 649).

Mr. Polk said he knew what equipment equally as good could be purchased and installed for. Mr. Crumb said the same thing. (Record, p. 896).

Mr. Levings said that the standard switch board furnished by the Independent Companies was as good as the switch board furnished by the Western Electric Company. (Record, p. 1524).

All three of these gentlemen have had wide experience with switch boards constructed by the Western and by other companies. Mr. Levings worked for two years with the Western Electric Company. (Record, p. 1521).

Mr. Jagoe placed a value of \$188,000.00 on the main exchange.

Mr. Smith, (page 330), Mr. Crumb, (page 877), and Mr. Polk, (page 1507), all testified that the main exchange was equipped for 4,800 circuits.

When the appellee bought the Ohio Valley plant in had only the main switch board. Mr. Jagoe, (page 648), said that switch board originally cost \$100,000.00 which was in 1896 or 1897. Starting with this \$100,000.00 it is an easy matter from Mr. Smith's deposition to determine the cost of the additions to this switch board.

Mr. Polk, (page 1507), said the main exchange was equipped for 4,800 lines or circuits. Mr. Crumb, (page 877), said the same thing. Neither of these statements is denied anywhere in the record.

Mr. Crumb, (page 877), said there were now 20 sections of switch board in the main exchange. Mr. Jagoe, (p. 648), said that it had 15 sections in 1900. Turning to Mr. Smith's deposition, we find what equipment has been installed in the main exchange since 1900.

Mr. Smith produced a voucher dated November, 1900, for \$12,000.00, which he said represented the purchase of the 16th and 17th sections of the switch board in the main office. This was the first voucher representing an expenditure for switch boards after the purchase of the Ohio Valley. (Record, p. 329).

Mr. Smith produced a voucher dated December, 1901, representing the expenditure of \$17,000.00 which Mr. Smith said represented additional switch board sections installed in the main office. (Record, p. 330).

On page 330, Mr. Smith read part of the above voucher which showed that these sections were sufficient to take care of 4,800 lines or circuits.

Now, if the \$12,000.00 mentioned in the first voucher represented the cost of sections 16 and 17, it would be

natural to assume that the \$17,000.00 mentioned in the second voucher represented the additional three sections going to make up the 20 sections which Mr. Crumb said were there. Added weight is given to this assumption when the record discloses the fact that the \$17,000.00 voucher purchased sufficient new sections to take care of 4,800 subscribers, and further that the present switch board in the main exchange has now a capacity of only 4,800 subscribers. The total of the above two items added to the \$100,000.00 representing the cost on January 1, 1900, makes a total cost of the main switch board of \$129,000.00 as against Mr. Jagoe's present valuation of \$188,000.00.

As to the cost of the switch boards in the East, West and South exchanges, Mr. Smith produced vouchers showing what they cost and there is, therefore, little chance to escape those figures.

In valuing those three switch boards Mr. Polk, Mr. Crumb and Mr. Jagoe show substantially the same figures.

It should be borne in mind, in this connection, that Mr. Polk and Mr. Crumb placed on these three switch boards a valuation without knowing what they had cost, whereas Mr. Jagoe said in so many words that he obtained his valuation from the actual invoices.

While cross examining Mr. Smith, page 336, I was handed one voucher by inadvertence which contained among other things a voucher representing the purchase of a switch board in Nashville from the Western Electric Company. I had Mr. Smith read into his deposition a part of that voucher, which is as follows:

“Cost of Nashville switch board, power plant, power switch board, generator, equipment, storage

plant, conduit and cable in this building, chief operators, wire chief section, etc., \$75,769.87, connected and ready for use as equipment for 4,500 circuits, cost per circuit \$16.83. Cost of toll board not included."

According to Mr. Jagoe's valuation the switch board in the main exchange is over \$39.00 per circuit (there being 4,800 circuits in that exchange), which is more than twice what the actual invoice from the Western Electric Company shows that the appellee paid for a switch board of a similar character and practically of the same capacity.

Again, Mr. Jagoe included as a part of the cost of equipment about \$22,000.00 for supervision. (Record, p. 649). It is apparent from what Mr. Polk said (page 1410) and from Mr. Smith's deposition that the Western Electric Company supervises the installation of all exchange equipment and turns it over ready for use. (See Record, pp. 331, 332, 339, 340). I call especial attention to the language of one of the invoices furnished by the Western Electric Company, which contained the following language (Record, p. 340):

"The invoice, dated August 1, 1903, reads, in part, as follows: 'To first installment of 25 per cent due this date for the *furnishing and installing* of 5 sections 6 panel 2 operator No. 1 relay multiple switch board equipped for 9 subscribers' and 1 testing operator; 2 1-3 sections 6 panel 2 operator No. 1 relay multiple switch board equipped for 3 trunk and 1 switching and incidental trunk operators, at West Exchange, Louisville, Ky., amount \$4,095.00."

Mr. Polk, said that his experience with the Western Electric Company was to the effect that they do not even permit the employes of the appellee in the room where the equipment is being installed. (Record, p. 1410).

Certain it is that \$22,000.00 for supervising something which the Western Electric Co. does not permit supervision of can not be accepted.

Now when we come to compare the switch board values as placed by Mr. Jagoe, Mr. Jackson, Mr. Polk and Mr. Crumb, we find a marked difference between Mr. Jagoe and the other witnesses. Here is a table showing the valuation and the investment for each subscriber as shown by the four witnesses. The amounts appearing opposite the names of Mr. Jagoe, Mr. Polk and Mr. Crumb, represent the value placed by each of them respectively on all four of the switch boards. The value appearing opposite Mr. Jackson's name is the value placed by him on all of the switch boards of the Bell Company in Massachusetts, there being 200,000 subscribers to that entire system.

Jagoe: value \$309,000; 9,300 subscribers; \$33 per subscriber.

Jackson: value \$4,000,000; 200,000 subscribers; \$20.00 per subscriber.

Polk: value \$203,000; 9,300 subscribers; 21.00 per subscriber.

Crumb: value \$180,000; 9,300 subscribers; \$19.00 per subscriber.

SUBSCRIBERS' EQUIPMENT.

Mr. Jagoe placed a valuation on subscriber's equipment as follows: \$184,465.15.

Mr. Polk placed a valuation on subscribers' equipment as follows: \$128,755.00.

Mr. Crumb placed a valuation on subscribers' equipment as follows: \$100,000.00.

Subscribers' Equipment means the desk stand or wall bracket used by the subscriber when he wishes to connect with other subscribers.

Here again it is simply a question of whose valuation is to be accepted.

We especially call the Court's attention to the method used by Mr. Jagoe in arriving at the value of this equipment, (p. 650). He placed a value of \$11.35 on each of the 9,395 instruments, or a total of \$106,000.00. He then placed a value of \$15.50 on each of 2,417 stations connected with private branch exchanges. These 2,417 instruments are simply extension sets and are a part of the 9,395 instruments first valued. It would, therefore, seem that Mr. Jagoe in his first item of 9,395 instruments at \$11.35 each should have deducted the 2,417 instruments connected with private branch exchanges as they seem to be valued separately.

Mr. Jagoe also added \$24,045.79 for supervision. This means that for every telephone instrument installed the company has been compelled to expend almost \$3.00 to have some one go around and tell the instrument setter where to put the instrument whereas, the well known practice is for the instrument setter to put the instrument wherever the subscriber wants it.

Again, Mr. Jagoe said there were 112 private branch exchanges as shown by the *telephone directory*. Mr. Smith showed in his Exhibit No. 6 that there were only 75 private branch exchanges. Mr. Jagoe said that if Mr. Smith's Exhibit No. 6 showed only 75 private branch exchanges then there were only 75 private branch exchanges. Mr. Polk pointed out in the telephone directory the names of

several subscribers who appear therein as having private branch exchanges. It was there shown that these subscribers have what is termed an intercommunicating plug-box, which possibly cost \$2.00.

Mr. Polk (p. 1408), Mr. Crumb (p. 896) and Mr. Levings (p. 1529) all said that they were familiar with the instruments and apparatus used in subscriber's stations in connection with telephone service and that the standard equipment used by independent companies was equally as good, if not better, than that used by the appellee; that it could be purchased by the appellee from the independent manufacturers, that it would perform the same functions in identically the same way as that used by the appellee that they knew the cost of it, and that they knew it could be furnished and installed for the values fixed by them. It does not appear that Mr. Jagoe ever purchased or installed any such equipment, and, in view of the inconsistencies in his figures, it seems to us that the Court should accept Mr. Polk's, Mr. Crumb's and Mr. Levings' valuation rather than the valuation of Mr. Jagoe.

CONDUITS.

Mr. Jagoe placed a value on the Conduits at	
40 cents per foot	\$170,676.96
Mr. Polk placed a value on the Conduits at	
20 cents per foot	\$95,082.00
Mr. Crumb placed a value on the Conduits at	
20 cents per foot	\$100,000.00
Mr. Levings placed a value on the Conduits at	
20 cents per foot	\$100,000.00

Mr. Jagoe said that he never built a conduit system in Louisville, and it does not appear that he ever built one anywhere. (Record, page 641).

Mr. Polk said he had built a conduit system in Louisville and he gave the names of 16 other cities in which he had constructed such conduit systems (p. 1493).

He said that the conduit system he built for the Home Telephone Company in Louisville was better and would last longer than the appellee's conduit system and that it cost less than sixteen cents per foot.

Mr. Jagoe agreed with Mr. Polk as to the number of duct feet and character of construction of the conduit system, but placed a reproduction value of \$170,384.21 which is at the rate of 40 cents per duct foot.

Mr. Wilkinson in his report (p. 756) showed that the underground conduit for the entire system had cost the Ohio Valley Company, \$108,313.61.

Capt. Gifford showed that there was considerable conduit construction in New Albany, Ind., at the time of the consolidation.

It is, therefore, impossible to tell the extent of the conduits in Louisville in 1900.

Mr. Hume, the General Manager, said that the conduit system as it now existed in Louisville was practically all constructed by the Ohio Valley Company, and said further that perhaps as much as 15 per cent of the conduit system as it now exists had been constructed by the Cumberland Company. (Record, p. 695). If 15 per cent be added to the \$108,313.61 above referred to, it will show a total of \$124,000.00.

Mr. Crumb placed a value on the conduit system of \$100,000 which is at the rate of 20 cents per foot and said that he had built conduit systems in Chicago, Pittsburg and numerous other cities and that he knows it can be constructed here in Louisville for twenty cents per foot. He said he would contract to do so and give a bond to carry out his contract.

Mr. Jagoe said that the report of Mr. Jackson of the Massachusetts Highway Commission showed that he (Jackson) placed a value on the conduit of 53 cents per foot.

Mr. Jackson's report shows, and the evidence in this case shows, that it was based on an inventory made by the telephone company itself and that Mr. Jackson simply checked up part of it to ascertain in a general way whether the inventory was correct.

Mr. Polk said that Mr. Jackson was an electrical engineer and not a construction engineer; that he had never constructed a telephone plant and that he knew nothing about what it would cost to construct conduits. (Record, p. 1433).

Mr. Polk further said that he believed he had constructed more conduits than any other construction engineer in the United States, and that he absolutely knew what it would cost to construct such conduits, and that he never heard of a conduit system costing over 25 cents per foot.

Moreover, it is impossible to know anything about the nature of the streets under which the conduits were constructed in Massachusetts. It may be that those conduits are constructed through solid rock, or of an entirely different material, for all this record discloses. Certain it is

that a conduit system such as the appellee has in the City of Louisville can be constructed new throughout for 20 cents a foot.

Appellee's counsel say that if Mr. Jackson's figures are correct then basing his valuation on the amount of material in the Louisville plant as found by Mr. Jagoe it would appear that the plant was worth more than \$1,700,000.00. In this counsel are in error. I have made a careful calculation based on Mr. Jackson's figures as to unit of cost, the result of which is as follows:

Conduits	\$235,000.00
Cables	540,000.00
Aerial wire	120,000.00
Poles	148,000.00
Switch boards	186,000.00
Subscribers equipment	148,000.00
<hr/>	
Total	\$1,377,000.00

The above figures for conduits are excessive to the extent of at least \$135,000.00, due to his valuation of 53 cents per foot.

It is also excessive because it includes all of the cable, appearing on the blue prints, whereas 35 per cent of the cable, as shown by Mr. Polk and Mr. Jagoe is not being used and is not in reality a part of the plant. 35 per cent of \$540,000.00, the value placed on the cable, is about \$180,000.00. Deducting these figures from the above total, the result, according to Mr. Jackson's figures, shows that the plant of the appellee in Louisville can be reconstructed for less than \$1,000,000.00.

Mr. Jagoe says that a calculation based on Mr. Jackson's figures would show that the Louisville plant would cost over \$1,700,000.00 to reproduce it.

Mr. Jackson's report is part of the record and it can be definitely ascertained what it would cost under his figures to reproduce the Louisville plant. Mr. Jagoe is simply mistaken.

Certain it is that Mr. Jackson in his report valued the entire Boston plant at \$92.00 per station.

Mr. Jagoe admits this to be true, (Record, p. 660) but contends that there is more material per subscriber in the Louisville exchange than there was in the Boston exchange. § 93

The question, therefore, is whether Mr. Polk's figures as supported by the record, and as supported by Mr. Crumb, and Mr. Levings, are to be accepted, or whether Mr. Jagoe's figures as discredited by the record are to be accepted.

There is in the City of Louisville another telephone plant, viz., that of the Louisville Home Telephone Company. This telephone plant was built in 1901, and in 1908 it had 9,938 subscribers, about 400 more than the appellee had (see Record, p. 1520). The City employed Mr. Polk (the engineer in charge of constructing that plant) to inspect and value the appellee's plant because it realized that Mr. Polk would know more concerning the character of construction than any other telephone engineer. Mr. Polk said that the Home Telephone plant was built more substantially and of better material than the plant of appellee; would perform its functions better than the appellee's plant and would outlast that plant (Record, p. 1406). In speaking of what it had cost to construct the Home Telephone plant Mr. Polk said:

"It was less than \$1,000,000.00 at the time they had the same number of circuits in use that the Cumberland Company now has." (Record, p. 1411.)

That was when the plant was new, not at a time when it had been constructed by piece-meal over a period of twenty years. Mr. Polk said he had purchased all the material that went into the Home plant; employed all the labor used in constructing the plant, and that he knew exactly what it had cost to construct that plant (Record, pp. 1494, 1495). He said he knew the nature of the material and character of construction of appellee's plant, and that the plant of the Home Telephone Company was constructed as substantially as was the plant of the appellee. *Mr. Polk's evidence in this respect is not controverted anywhere in the record.* (Record, p. 1494.)

As to the rates, earnings and expenses of the Louisville Home Telephone Company's plant, see this brief, pp. 192 to 193.

RESUME AS TO VALUE OF PLANT.

Mr. Crumb, (page 887) and Mr. Polk (page 1511) both said that the plant in its present condition was worth from 20 to 25 per cent less than it would be if constructed new throughout. The Master found that certainly it was 10 per cent less valuable. 2 3 5

Mr. Hume said that most of the plant had been in existence for more than five years (p.694).

The main switch board was installed 14 years ago, and all the witnesses with the exception of Mr. Jagoe, said that the life of a switch board was from 15 to 20 years. Mr. Jagoe said that it was indestructible (Record, p. 648).

The Master found that after deducting 10 per cent from the reproduction value of the plant, which 10 per cent represented what the plant had depreciated since its

construction, that the plant was now worth \$1,243,011.97. These figures are certainly more than liberal to the complainant. There is nothing in the record which will justify the appellee in objecting to that finding of the Master. Appellant might justly object to the Master's conclusion as to value, but certainly the appellee has no ground for complaint.

The lower Court discusses at length the above mentioned finding of the Master and held that there was no occasion for the 10 per cent reduction because, according to the Master's report, the plant was in prime condition and performing its functions as well as a new plant.

In view of the opinions of this Court in numerous cases the conclusion of the lower Court is inexplicable. It is self-evident that appellee can only be allowed to earn a return on the value of the plant as it was when the Bill of Complaint was filed. The plain, simple method of determining that value, is to ascertain what it would cost to reproduce the plant new throughout and then deduct therefrom a sum sufficient to represent the difference between the reproduction value of a new plant and a plant that has been used for years. This was the course pursued by the Master, and is the course which the lower Court held was erroneous. It is apparent that the switch board in the main office of appellee, which cost \$120,000.00 and which has been in service for twelve years, is not as valuable as a new switch board. That switch board performs its functions as well as a new switch board no doubt, but it will not perform those functions longer than four or five years, whereas a new switch board would perform those functions fifteen or twenty years. Likewise a line of poles con-

structed ten years ago. Such line of poles will perform its functions as well as a new line of poles. However it will last only three or four years more, whereas a new line of poles will last fourteen or fifteen years. The same is true of every part of a telephone plant.

Appellee's plant at Louisville has been in existence since prior to 1886. Some parts of it have been reproduced many times. Some parts of it are practically new. Other parts will have to be renewed from year to year. It is, therefore, self-evident that appellee's plant is at least ten if not twenty-five per cent less valuable than it would be if new throughout.

When the lower Court's erroneous findings of fact as to the value of the plant, referred to on pages 34 to 38 of this brief, are deducted from the Master's valuation of the plant, the valuation was shown to be \$1,501,000.00.

Had the lower Court observed the plain logical rule laid down by this Court, viz: of deducting from the reproduction value of the plant, a reasonable sum to represent depreciation, then the value as found by the Court would not have exceeded the value as found by the Master, viz: \$1,243,000.00.

VALUE OF PLANT ACCORDING TO THE ARGUMENT OF COMPLAINANT'S COUNSEL.

Counsel for appellee in their argument below stated that the appellee would accept the valuation of the Master, to-wit, \$1,243,011.97, provided there should be added to this figure, the following items:

- (a) Franchise.
- (b) Supplies on hand.

(c) Working capital.

(d) Business as going concern.

Making a reasonable allowance for these items counsel stated that the value would be brought up to \$1,500,000.00. That this figure would be satisfactory to them.

We think we can demonstrate that no additional allowance should be made for the items mentioned.

In the first place if the contention of the City is upheld in the franchise case (No. 197, October Term of this Court) then appellee has no franchise to occupy the streets of the City of Louisville.

In *Knoxville vs. Knoxville Water Company*, 212 U. S. 1, the Court said that the true valuation would be the cost of reproduction less depreciation.

(a) Should value of franchise be considered?

Counsel referred to the case of *Monongahela Navigation Company vs. United States*, 148 U. S. 312, an opinion by Justice Brewer. The question discussed there involved the purchase of a lock and dam and it appeared that its owner had valuable rights in the nature of tolls; and being a sale of the property the Court, very properly, we think, states that an allowance should be made for this item, to-wit, the franchise, or right to collect tolls.

In *Willcox vs. Consolidated Gas Company*, 212 U. S. 19, also referred to by counsel, it appeared that the Consolidated Company had actually expended \$7,000,000.00 for franchises they had purchased. And hence covering this outlay, the Court stated that in arriving at the value of the plant this should be taken into consideration, but it will be noted that nothing was stated about any franchise rights the Consolidated Company had as such, distinct from those purchased and actually paid for.

No case will be found involving the fixing of rates, where the value of franchises are included in finding the valuation of a plant. It is easy to see how the two foregoing cases are distinguished. One being the actual expenditure of money for franchises, the other involving the sale of property.

In Beale and Wyman's *Work on Railroad Rate Regulation*, Section 362, the author lays down the rule that the value of franchises should not be considered in estimating rates. Part of said section being as follows:

"It must be clear that in estimating the capital upon which a public service company is entitled to a fair return, the value of a franchise enjoyed by the company cannot be considered. The value of the franchise is itself based on the capacity of the company to earn profits; and it becomes greater when the earnings of the company are increased. If, therefore, a high rate of income could be justified on account of the great value of the franchise, this fact would in turn enhance the value of the franchise itself and so justify a still higher charge; and there would be no limit to the legal charge of the company until the limit of charge which was in fact possible as a matter of business had been reached."

To same effect is *Brunswick & T. Water District vs. Maine Water Company*, 99 Me. 371, 59 Atl. 537.

We desire to call the Court's attention to the fact that the only franchise anywhere mentioned in the proof was the amount paid by appellee to the Ohio Valley Telephone Company. The purchase price paid that company did include a valuation placed upon said company's franchise.

Having expended that sum the Master allowed it in his findings. Thus we see he has literally followed the rule in *Willeox vs. Consolidated Gas Co.*, *supra*.

The lower Court refused to add anything to the value of the plant representing the value of appellee's franchise. (Record, p. 1627.)

(d) Business as a going concern.

We desire to call the Court's especial attention to the fact that all the cases referred to by complainant's counsel wherein the item of a going concern was allowed, are those involving the sale of the properties. This item (going concern) is in the nature of the good will, and we do not think counsel seriously contends it should be considered. It is certainly true that appellee never thought of giving any such an item in making its return for taxation, or when it filed its Bill of Complaint.

The cases referred to by counsel are as follows:

(a) Gloucester Water-Supply Co. vs. City of Gloucester, 177 Mass, 365, 60 N. E. 977. This involved the sale of a water plant to the City of Gloucester, under statute, and the Court refers to this item as a proper item for consideration.

(b) National Water Works vs. Kansas City, 62 Fed. 853. This involved the sale of the water works of Kansas City. The company sought to have a valuation of \$4,500,000.00 fixed, as they claimed on a 6 per cent basis. The city contended the value should be the actual cost of reproduction. The lower Court fixed the value at \$2,714,000.00; the Circuit Court of Appeals fixed it at \$3,000,000.00. The difference was due, as is shown in the opinion of the Court, to the fact that the value of the connections between the water mains and the houses of the customers was included. In other words, the Court reached the only conclusion possible, that the mere reproduction of the pumping station, reservoir and mains could accomplish nothing. That

it was necessary that the connections be made to give value to the company as a going concern, and that these connections were valuable rights and should be considered. This same rule would not apply in the case at bar because the valuation as fixed by the Master embraced all the property of the Telephone Company, and necessarily includes the wires from the trunk lines into the residences or business houses as well as the telephone instruments and all paraphernalia. The telephone company owns all these, whereas in the water works case all the attachments from the property line were owned by the customers. Hence it is clear that the same rule should not and could not apply in this case.

But as before stated, that was a case of a sale and not the fixing of rates.

(c) *City of Omaha vs. Omaha Water Company*, 218 U. S., decided May 31, 1910, in an opinion by Mr. Justice Lurton. The Court, after referring to the Knoxville Water Co. case and the Consolidated Gas Company case, makes this very positive and significant statement:

"Both cases were rate cases, and did not concern the ascertainment of value under contracts of sale."

Language could not have been used to more clearly fit the case at bar. The pending suit does not involve the sale of the property, but only the fixing of rates, and hence the item contended for by complainant is not a proper one, and should not be allowed.

The lower Court refused to add anything to the value of the plant representing the value of appellee's good will.

There is not one line of evidence in the entire record showing the value of either the franchise or the good will

of complainant company. Numerous witnesses testified and were cross-examined most extensively, and yet no one was ever asked to place a value on either the franchise or the good will. (Record, p. 1627.)

SUPPLIES.

Concerning the question of supplies on hand, it has been shown in the former part of this brief that the appellee has a supply department at Louisville for a large territory; that to all the supplies taken out of its supply department for the use of Louisville there is added 10 per cent on the cost price thereof. (See this brief, pp. 50-69.)

In discussing appellee's method of treating the supply department the Master used the following language in his report (Record, p. 64) :

"Mr. Smith, on page 256 of this deposition, says as to the added charge of ten per cent for supplies, that it was to cover freight, drayage, rentals, etc.

"I find that this charge on all supplies furnished is at least a burden on the business in Louisville, and should not be allowed. The company in the first instance must have paid freight and drayage on all supplies furnished. The company doubtless received the usual trade discount for cash. As to how the freight and drayage were charged, or the cash discount discount credited, the record is silent. I do not doubt that proper and correct entries were made on the company's books as to the rent of the supplies warehouse. This is doubtless charged to expense of supplies."

* * * * *

"I find, therefore, that this added charge of ten per cent on the cost of supplies furnished to the Louisville exchange must be disallowed."

It is conceded that a telephone company operating a plant in one city needs supplies, and that such company

would be entitled to earn a dividend on the value of the necessary supplies. That is not the situation as it exists in the case at bar. The plant at Louisville does not own any supplies or keep any supplies on hand. The company which owns the Louisville plant keeps a large supply house at Louisville for a large district and sells to the Louisville plant the supplies that it needs, adding ten per cent to the cost price thereof. Appellee is, therefore, earning ten per cent on the value of its supplies at Louisville, and it cannot in addition thereto be allowed to earn seven per cent on the value of those supplies.

Moreover, there is not one line of evidence in the record to show the value of the necessary supplies for the Louisville plant.

The allowance of an amount to cover the item of supplies by the lower Court is assigned as error. (See Record, p. 1647.)

WORKING CAPITAL.

In Mr. Polk's estimate of reconstruction value of the plant there is added a sum to represent working capital. There is nothing in the Master's report to show that his valuation of \$1,243,000.00 did not include a sum representing working capital. But irrespective of whether the Master included working capital, the fact remains that the valuation fixed by him at \$1,243,000.00 is in reality in excess of what the evidence justified and there is no occasion for adding any sum to his finding to represent working capital.

The fact is, the telephone business is a cash business. As operated in the past telephone patrons have paid their rentals three months in advance in order to get the discount, the rates on almost all classes of service being sub-

ject to a discount of fifty cents per month. (See Record, p. 1618.) This being true, there is no necessity for working capital to any considerable extent.

Consideration of the average cost of reproduction.

Counsel in argument suggested that they should not be held to an estimate of the cost of reproduction in a given year. Especially where there is any material change in the cost of reproduction. That an average should be found as to what it would cost in a given number of years and the average taken. We call the Court's attention to the fact that the Cumberland Company is complainant here, and furthermore that there is nothing in the record to show that the year the ordinance was passed was an off or bad year. But, be this as it may, *Willcox vs. Consolidated Gas Company*, *supra*, settles this proposition, the Court stating on page 52 that the value should be fixed as of the date of inquiry.

Mr. Jagoe said that the present price was about the same as the average price for the last eight years.

Mr. Polk said that up to 1905 the prices were higher.

Mr. Smith's Exhibit No. 2 shows that only a very small proportion of the entire construction cost has been added since 1905.

EARNING.

The two accountants who examined the books and records of the appellee reported to the Master concerning the earnings for the years 1905, 1906, 1907 and 1908.

In arguing the case before the Master, and before the lower Court, counsel confined themselves to the earnings and expenses for the year 1908, and the conclusions of the

Court below are based on the earnings and expenses for 1908, and the application of the rate ordinance to those earnings and expenses.

In order to avoid confusion, I will discuss only the earnings for the year 1908.

The accountants reported to the Master in their joint report that the earnings for 1908 were \$325,838.30, (see Record, p. 78).

This item, as shown by the Master's report, and by the joint report of the accountants, included \$7,632.11, which represented 15 per cent of the earnings of the toll department on outgoing messages from the Louisville exchange. The other 85 per cent of the toll earnings were credited by the appellee at its home office in Nashville, as earnings of the toll department. This 85 per cent for the year 1908 amounted to \$43,248.70, (see Record, p. 79).

The Master reached the conclusion that all of the toll earnings taken in at the Louisville exchange, were earnings of the Louisville exchange and he therefore added to the \$325,838.30, the additional sum of \$43,248.70, representing the balance of the toll earnings (the 85 per cent) making a total of \$369,087.00, being the amount which the Master found to be total gross earnings of the appellee on its property. The Master's finding in this respect was vigorously attacked at the argument below, and the lower Court overruled the Master's finding, but held that a small portion of the \$43,000.00 above referred to, viz., \$5,088.00 should be credited to the Louisville exchange as the earnings of that exchange, (see Record, p. 1631). This \$5,088.00 added to the \$325,838.30, which the accountants found to be the earnings, or a total of \$330,918.00, the Court found

to be the earnings of the appellee for the year 1908, as against \$369,087.00, the amount which the Master found to be the earnings for that year. (Record, p. 1631.)

The reasons given by the Master for his findings, in this respect, may be found on page 78 of the record, and are as follows:

"The Toll Department, which handles long distance messages, is so intimately connected with the exchange and its operations, that it is difficult to segregate them; the operators are largely engaged in handling both local and long distance business; the pole lines leading out of the exchange carry both toll lines and exchange lines; the maintenance of these pole lines is borne by the exchange, and nearly all of the cost of operating the toll business is borne by the exchange; the Toll Department occupies a part of the Main Exchange Building, yet it pays no rent nor taxes nor cost of repairs or maintenance. In addition, Mr. Smith, the auditor of complainant, pages 258, 265 and 266, frankly states that the cost of construction or reconstruction of the toll switchboard, was paid for by the exchange and charged to Construction Account of Exchange.

"I fail to see any just reason for separating the earnings of the Toll Department from the earnings of the exchange. If all the toll earnings be given to the exchange, and the expense of toll operations and the taxes and insurance be paid out of exchange earnings, the result will not affect the net cash receipts of complainant.

"I have given this matter much thought and consideration, and I am satisfied that the arbitrary division of the toll revenues at Louisville between the complainant and the exchange, under all the existing conditions above enumerated, is unjust and inequitable and should not be approved.

"It is, perhaps, not unnatural in this controversy, that complainant should, by all plausible means, undertake to increase its expense account and decrease its revenue account. This effort on its part involves

no moral problem, but is purely and simply a question of business propriety. It is more strictly a matter of bookkeeping."

Mr. Smith, (Record, pages 331-327), produced vouchers showing that the cost of toll equipment in Louisville had been charged as a part of construction of the Louisville exchange.

On pages 443-4, 286-7, 456-7, he said that where toll lines were built in the city, which toll lines were used in part for exchange wires, the cost was charged to construction.

It is true that Mr. Smith, (and possibly Mr. Caldwell), did say that the construction of the toll exchange and toll lines was kept separate and distinct from the construction of the exchange proper. If so it is one of their general statements which is absolutely refuted by the record. *Every voucher produced wherein any part of the cost of constructing toll lines was involved, was charged up directly as a part of the construction of the Louisville exchange. All toll equipment was charged up as a part of the cost of the Louisville exchange.* It, therefore, seems to us that the Court should not accept the general statements of the officers on this subject when their records absolutely refute their statements.

Here is one extract from Mr. Smith's deposition on this subject (Record, p. 331):

"Q. I notice on page 6 of this invoice, third section of toll equipment and on page 7, keyboard equipment and on page 8, fourth section of toll switchboard, and on page 9 keyboard equipment, and I would ask you if the items following the third section, toll switchboard on page 6 and the other items down to miscel-

laneous switchboard material on page 9, was for material used in connection with toll switchboard?

"A. The invoice states so.

"Q. Are the items for toll switchboards and other material and labor in connection therewith, which appear in this invoice for \$17,000, a part of the \$178,000 charged to construction of the Louisville exchange for the year 1901?

"A. These vouchers are for the year 1902. The total of this invoice is included in the total of the Louisville construction account and properly so, for the year 1902."

As to maintenance: Men whose payrolls were charged against the expenses of the Louisville exchange maintained the toll lines not only in the City limits, but outside of the City limits. (Record, pp. 286, 287, 288.) Here is a part of what Mr. Smith said on that subject:

"Q. What was the money represented by that amount paid out for?

"A. For the board of 22 head of horses for the month of July and for the hire of horse and buggy to go to Pleasure Ridge Park on local trouble.

"Q. Where were those horses used?

"A. They were used for many purposes. Some of them for repairing telephones, some of them were dray horses with construction gangs.

"Q. Were they used at all in the construction or repairing of toll lines?

"A. There is nothing here to indicate that.

"Q. Do you know whether or not they were so used?

"A. If the toll line in the district was in trouble that could be reached by a vehicle, they probably repaired it." (Page 286.)

Again in this connection Mr. Smith said:

"Q. And would they take these horses and use them out on these toll lines?

"A. They possibly might have done so." (Page 287.)

Again in this connection Mr. Smith said:

"Q. I didn't get a satisfactory answer, or rather a succinct answer to my question about whether you would send out wagons and teams from Louisville, Ky., to Anchorage or to Jeffersontown and places of that size surrounding Louisville, should you have occasion to make any repairs or to do any new construction work in those vicinities?

"A. If it is necessary I should say we would do so." (Page 287.)

Again in this connection Mr. Smith said:

"Q. If it was the regular team, that would not be charged up to toll lines?

"A. Well, probably not."

Mr. Warren, the City's accountant, testified as follows (Record, p. 1052):

"Q. Now during the time you were examining the construction vouchers, did you ever come across *any payroll* vouchers wherein any employees seemed to have been paid or appeared to have been paid for services in connection with toll line construction in the City of Louisville?

"A. No, sir."

Mr. Warren, in his Exhibits Nos. 9, 10, 11 and 12, (Record, p. 1122) showed that the expenses made necessary on account of the toll department for the four years in question were as follows:

1905.....	\$22,536.25
1906.....	24,671.90
1907.....	24,478.86
1908.....	20,239.65

It will be remembered the Master reported, (Record, p. 75) that the 15 per cent credit to the earnings of the

Louisville exchange on account of the toll department for the four years in question was as follows:

1905.....	\$6,539.92
1906.....	7,064.91
1907.....	8,030.15
1908.....	7,632.11

The above figures of the City's accountant were arrived at as follows, as shown by Mr. Warren's deposition (Record, page 1086):

"Q. Did the payrolls for the year 1905 show any salaries and wages paid out on account of employes in the toll department?

"A. They did.

"Q. Just explain in a general way what class of employes appear on those payrolls as employes in the toll department?

"A. Toll operators, the toll chief operator and assistant, the telegraph operator, the toll trouble man, the messenger boys, toll clerks, and the toll switching operators."

Mr. Warren then said that the above employes were designated on the payrolls as toll employes and their salaries were charged up as a part of the expenses of the Louisville exchange.

Mr. Warren further testified as follows (Record, p. 1087):

"Q. I notice in the report made by the Mutual Audit Company to the Master in this case, that it shows that salaries and wages under the heading of operating expenses to the extent of \$13,269.95 were required and expended at the Louisville plant on account of salaries and wages for employes connected with the toll department. Will you please explain how that item was arrived at?

"A. We listed from the payrolls of the salaries and the wages paid to the toll operators, we also listed all the salaries paid to toll wire chief and the telegraph operators and their assistants whenever they had any. We also took the chief toll operator and the private branch exchange operators in hotels and buildings, and charged one-third of their time to the toll work. Our reason for so doing was the knowledge that the private branch exchange operators in all the hotels do a great deal of long distance toll work and our information was to the effect that the chief operator spent a great deal of her time in the toll department. We therefore considered one-third of the pay of these people mentioned to be a fair proportion chargeable to the toll department. We added to these figures all of the toll clerks' salaries, all of the messengers, and one-tenth of the salaries of various collectors. We did this for the reason that the toll clerks are busy making out statements of toll accounts and the messenger boys are used for service on long distance calls only, and the collectors we considered one-tenth of their time to be a very small percentage occupied in the collection of accounts and indebtedness due to the toll messages. I could go on and say that these items which I have just outlined added together make a total of \$13,269.95."

Mr. Warren then showed the percentage of the toll earnings to the gross earnings of the exchange.

For 1905 the toll earnings represented 16.92 per cent of the total earnings. For the year 1908, 15 per cent.

In his depositions, (Record, page 1100), we had him give a detailed statement of what the general expenses and other items of a similar nature made necessary on account of the toll business and exchange business amounted to, and had him show what amount was properly chargeable to the toll department. The items on which this

percentage was estimated are stated by Mr. Warren in his deposition and are in a general way as follows:

16.92 per cent of the amount paid for rent on the main exchange.

On page 1088 of the record, Mr. Warren said:

"The rental of the main exchange for the year was \$7,200, and we proportioned 16.92 to the toll department on that amount only, charging them nothing for light or heat because it was impossible to arrive at any light or heat figures, and we did not charge any proportion of rent, light or heat on the sub-exchanges," (meaning East, West and South).

16.92 per cent of the insurance paid on the main exchange.

Mr. Warren said (Record, p. 1089) that this item represented "insurance on toll board and equipment, etc., pertaining to the handling of toll business."

On the same page (1089) occurred this question and answer:

"Q. I notice on the same page an item opposite damages and under the head of 'Charge toll department,' of \$1,500. Explain that item.

"A. That consists of the amount of damages paid to an operator for injuries received while in the performance of her duties at the Louisville exchange. This girl was a toll operator and performed toll work only, and was injured in the toll department.

"Q. How did you ascertain that fact?

"A. I inspected the voucher calling for the payment of this money. It had several papers attached to it, describing the nature of the injury, the cause thereof and the date thereof, and I inspected the pay-rolls on or about that day and for some time previous and found on that date and for several weeks previous she had been working as a toll operator."

On page 1089 of the record appears this question and answer:

"Q. Now the figures appearing on Exhibits Nos. 9, 10, 11 and 12 other than those agreed to by the accountants are derived from what source?

"A. They are derived from direct information which was taken from the books, records and accounts of the Cumberland Telephone Co."

None of the above facts are controverted.

In the \$20,000.00 which Mr. Warren said was shown by the books to be directly chargeable to the toll department there was not included any part of the salaries of the general officers or employes, superintendent or foreman, etc. On page 1100 of the record occurs this question and answer:

"Q. In connection with these expenses, (meaning the \$20,000.00), is there any part of the salary of the General Manager, Mr. Boardman, or the Superintendent, Mr. Hall, charged to the operations of the toll department?

"A. There is not."

On page 1098 of the record occurs this question and answer:

"Q. Does there appear in any of these Exhibits, Nos. 9, 10, 11 or 12 any percentage or portion of the salaries of any of the employes of the company such as foreman, laboring men, reconstruction force, maintenance forces, charged by itself to the toll department? I mean have you in these Exhibits deducted any portion of their salaries on account of labor they might perform in connection with the toll lines and the upkeep of the toll property?

"A. We have not."

Mr. Warren's Exhibit No. 12 for the year 1908 (Record, p. 1122) shows that the maintenance for that year amounted to \$54,000.00 and that the reconstruction amounted to \$31,000.00. It is fair to assume that 15 per cent of this was made necessary on account of maintenance and reconstruction of the toll lines, and toll equipment. This item in itself amounts to \$12,750.00.

The American Telephone & Telegraph Company owns the complainant. Only 8 per cent of the receipts for long distance messages going out of Louisville over the American Company's lines are credited to the Louisville exchange. Mr. Smith (Record, p. 370) said:

"Q. What does the American Telephone & Telegraph Company pay the plaintiff company for handling its toll messages?"

"A. The average for the three months, December, 1908, January and February, 1909, averaged eight and two tenths per cent."

Of course, the American Company can force the complainant to make any kind of contract it sees fit to make. The matter is purely a question of which pocket the money will go into.

The Master showed (Record, p. 150) that the receipts from the American Company on outgoing messages for the year 1908 were \$3,200. This was 8 per cent on \$40,000. Therefore, the Louisville exchange earned for the American Company, during the year 1908, \$40,000, and was only paid \$3,200, for its services. To earn this \$40,000 and the \$50,000.00 for complainant the Louisville exchange incurred *expenses amounting certainly to over \$30,000.00*, and in addition thereto a sum representing a portion of the salaries of the exchange operators (all of whom per-

form some service in connecting up the long distance calls).

The Master credited to the Louisville exchange for the year 1908 with toll earnings to the extent of only \$50,880.81. (Record, pp. 75-81.)

Appellee credited the exchange for the year 1908 with toll earnings to the extent of only \$7,632.11 (Record, p. 72).

The difference between the appellant and appellee as to how the earnings of the toll department should be treated may be stated thus:

Appellee contends that the exchange should be charged with the cost of all toll equipment; that the expenses of conducting the toll department should be borne by the exchange, and that 15 per cent of the toll earnings should be credited to the exchange to reimburse it for its outlay and services.

Appellee insists on this course being adopted because it is the plan pursued by it with all of its other exchanges.

If the appellee's contention is upheld then the exchange will receive for its expenditures and services in connection with the toll department the sum of \$7,632.11 per year.

The City, on the other hand, shows from the appellee's records that the actual salaries paid out by appellee during the year 1908 for all toll operators and employes was \$11,500.16 (Record, p. 1097), which amount includes no part of the general expenses, rent, taxes, insurance, maintenance, reconstruction and incidental expenses, all of which expenses are common to both the exchange and the toll department.

Appellant shows, however, from appellee's records that the earnings from the toll department represent 15 per cent of the gross earnings from both exchange and toll depart-

ments (Record, p. 1097), and that it is therefore logical to assume that 15 per cent of the gross expenses were made necessary on account of toll department.

This assumption should be given additional weight because of the failure on the part of the appellee to furnish a definite basis for separating the toll expenses from the exchange expenses.

Both Mr. Crumb and Mr. Polk stated that the basis insisted on by the City was fair to the appellee (Record, pp. 898, 899, 1508).

The City, therefore contends,

First, that the plan adopted by the Master should be upheld, or

Second, that all of the expenses made necessary solely on account of the toll department should be paid by that department, and that in addition thereto the toll department should bear 15 per cent of all expenses common to both the exchange and the toll department, such as general expenses, maintenance, reconstruction, rent, taxes, etc., or

Third, the toll department should be required to bear 15 per cent of the gross expenses of both exchange and toll departments as found by the Master.

The first plan contended for by the City will show:
 Exchange and toll earnings for the year 1908. . \$369,087.00
 (See Master's Report, Record, p. 79.)

The second plan contended for by the City
 will show:

Expended *solely* on account of toll earnings
 for the year 1908 \$ 11,590.16
 (See Record, p. 1097.)

Expenditures *common* to both exchange and
 toll department:

General expenses	\$ 42,076.75
Maintenance	54,705.91
Reconstruction	31,450.07
Total	\$128,232.73

(See Record, p. 72.)

Fifteen per cent of \$128,232.73	\$ 19,234.00
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Total of expenses to be borne by the toll de- partment	\$ 30,824.16
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The third plan contended for by the City
 will show:

Total expenses as shown by the Master \$216,-

363.07, 15 per cent of \$216,363.07	\$ 32,454.00
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In the Bill of Complaint a clean bill of health was
 given appellee by the Board of Trade. In the depositions
 of both Mr. Caldwell and Mr. Smith they speak at length
 about Mr. Munster's report. Mr. Munster was the ac-
 countant who investigated the books of the appellee for
 the Board of Trade. I had Mr. Smith produce that re-
 port and to read certain extracts from it into his depo-

sition. Those extracts deal with the earnings from the toll department and Mr. Munster there said (Record, p. 452):

"In the statement of results in Louisville, I have credited the full amount received from toll line service over the Cumberland Company's lines originating in the City of Louisville to the latter city's revenues, and the distribution sheets also show such credit. My opinion is that it should be so credited."

It seems therefore that Mr. Munster, the accountant for the Board of Trade, after examining the records of the appellee, reached the same conclusion that the Master reached.

Counsel for appellee contend, however, that if the Master's finding be sustained it will result in there being no fund available out of which to maintain and pay a dividend on the toll lines between the exchanges. If it be true, as we have shown, that the cost of the toll lines in each town and city and for a certain radius outside of the City limits, is charged as a part of the cost of the exchange; if it be true, as we have shown, that all the cost of maintaining those toll lines inside and outside the City limits is charged as part of the expense of the exchange, then there is no other expense, and there should be no such amount set aside out of earnings.

Take for instance Jeffersonville and New Albany. These two towns are six miles apart. Assuming that the toll calls over the line from New Albany to Jeffersonville and from Jeffersonville to New Albany amount to \$1,000 per year. The New Albany exchange we will say cost \$200,000 and the Jeffersonville exchange \$100,000. The American Telegraph & Telephone Company's report for

1909 shows that the toll lines cost \$610 per mile, so that including exchanges and toll lines the company has a total expenditure of \$303,660.00; \$300,000.00 of this is in Jeffersonville and New Albany. Only 15 per cent of the thousand dollars earnings is credited to each of these towns, or a total of \$150 for each town. Now this six mile toll line is maintained by Jeffersonville and New Albany. The cost of it is charged against Jeffersonville and New Albany. The earnings are all made possible by reason of those towns. And yet only \$300 of the \$1,000 earnings is credited to these two towns. The balance of \$700 goes into the general treasury of the company to swell dividends. The figures we have given may not be accurate, but this illustrates the point we are trying to make, which is, that as the cost and expenses of the toll lines is borne exclusively by the exchange, all earnings ought to be credited to the exchanges. 3/5 - 5-2 - 736

But, says the complainant, there is a custom existing between telephone companies to credit to the exchange only 15 per cent. The Master in dealing with this phase of the complainant's contention said (Record, p. 74):

"Custom of trade among merchants has generally received the sanction of the courts. The reason of this is obvious, because merchants trade with each other at arm's length, and what is generally done under such circumstances, ought to be and is generally upheld by the courts. But the custom here testified to is a very different thing from the custom of merchants. The parent company manages and controls its subsidiary departments as it deems best. The subsidiary department occupies no position of independence, and in fact does not and cannot raise a protest. And when it appears, as in this record, that the Louisville exchange is required to pay all or

nearly all of the operating expenses of the toll line department, and in return, is given compensation that is utterly insufficient to pay the expenses it is required to pay, such a custom does not and ought not to appeal to the judicial mind."

Moreover, the record discloses the fact that the toll department of the complainant, in the City of Louisville, actually earns over \$90,000 a year from the complainant, whereas the Master is only giving the Louisville exchange credit for about \$50,000.

It is a fact that the toll lines all carry lines for exchange subscribers, to farms, cross-roads merchants and doctors who are connected with either the Louisville or some other exchange, and this is true over the appellee's entire system.

Moreover, it is a fact that toll earnings are made possible solely by reason of the existence of the exchanges. If complainant did not have an exchange in Louisville its long distance business would not amount to \$5,000.00 a year. In such state of case it would be necessary for those desiring to talk over appellee's lines to go to its office. The result would be that practically no one would use the toll lines.

Mr. Caldwell and Mr. Hume try to make it appear that the toll lines are greatly advantageous to exchange subscribers. Of course, it is an advantage for the exchange subscriber (if he is a business man), to be connected with the toll lines, but it is more of an advantage for the complainant to have its exchange connected with its toll line. On this subject see Mr. Hume's deposition (Record, p. 695).

Again, three-fourths of appellee's subscribers do not make use of the long distance lines. To require the Louis-

ville exchange to maintain and provide the expense of the toll department is therefore to make three-fourths of the subscribers pay for something which they do not make use of and do not want.

The Master made his calculation on the theory that the toll lines, which he valued at \$112,000.00, should be added to the value of the plant. This course was pursued by him, because he credited all toll earnings on outgoing messages to the Louisville exchange.

If he is not upheld in this respect, then the value of the toll lines should not be added to the value of the Louisville change.

It is true the Master found that the earnings for the year 1908 would have been \$49,000.00 less had the rate ordinance been in force than they were under the rates actually in force. Exceptions were filed by the appellant to this finding of the Master, which exceptions were overruled by the Court and this ruling by the Court is assigned as one of the errors on which this appeal is prosecuted. (Record, p. 1650.)

THE \$49,000.00 ITEM.

In the early part of this argument (see p. 38 of this brief), I had occasion to refer to this \$49,000.00 item, but did not discuss it in detail. It will be remembered that the Master appointed two accountants, one on the suggestion of the City and one on the suggestion of the appellee. These two accountants reported to the Master (Record, pp. 100-103), that the earnings of the appellee, under the rates charged in 1908, would have been at least \$49,000.00 less than they were had the rate ordinance been in effect during that year. I have already exposed the

fallacy of the plan whereby the accountants reached this conclusion, (see this brief, pp. 39 to 44.)

Mr. Smith's Exhibit No. 6 shows the name of every subscriber to the exchange, and the class of service such subscriber had, that is, whether business direct, business party, residence direct, residence party or private branch exchange.

The rate ordinance in litigation declares what rate the appellee may charge for each of the above classes of service. When the rates named in the rate ordinance are applied to each subscriber whose name appears in Mr. Smith's Exhibit No. 6, according to the class of service such subscriber has, it will be seen that instead of there being a loss of \$49,000.00 as agreed to by the accountants there will be an actual increase in earnings.

In Mr. Smith's Exhibit No. 6, above referred to the names of the subscribers appear in alphabetical order from A to Z without any separation of the subscribers as to class of service. I had Mr. Warren, the City's accountant, go over Mr. Smith's Exhibit No. 6 and separate the subscribers as they appeared in that exhibit according to the class of service. Mr. Warren filed his Exhibits Nos. 14, 15 and 16, which is the result of his classification. (Record, pp. 1103 to 1107). In this Exhibit No. 14, Mr. Warren showed that he had gone through Mr. Smith's Exhibit No. 6 and classified the subscribers according to the character of service given each subscriber. For instance, all subscribers having direct business lines were placed together; all subscribers having direct party lines were placed under another head, etc. Mr. Warren (page 1101) said that he had placed every subscriber under the classification indicated on Mr. Smith's Exhibit No. 6 with

the exception of 41. These he had changed from the classification made by Mr. Smith to some other classification, and he explained (Record, p. 1102) why this change was made. These 41 names appear in Warren's Exhibit No. 15. (Record, p. 1102.) I can conceive of no criticism of Mr. Warren's figures in this connection except possibly in so far as private branch exchanges and pay stations are concerned. As to the private branch exchanges, Mr. Smith's Exhibit No. 6 shows that most of them are furnished free. These private branch exchanges as shown by Mr. Jagoe (Record, p. 651) are quite expensive. Mr. Smith's Exhibit No. 6 shows that the company charges \$5.50 to the Kentucky Distilleries & Warehouse Company for a private branch exchange with 10 stations attached. It charged the Louisville Lighting Company \$10.50 for a private branch exchange with 27 stations attached. It charges the P. C. C. & St. L. R. R. Co. \$6.25 for an exchange with 24 stations attached. It charges the Standard Oil Company \$5.50 for a switchboard with 6 stations attached. (See also Record Case No. 197, p. 181.)

Of course it must be assumed that the company will charge all of its subscribers alike and will not discriminate.

The New Orleans report filed with Mr. Smith's deposition (Record, p. 420), shows that private branch exchanges with 20 stations or less are charged for at the rate of \$5.50 per month. Private branch exchanges with 20 stations or more are charged at the rate of \$10.50. Inasmuch as \$5.50 is the lowest rate charged any Louisville subscriber for a private branch exchange, it must be assumed that the company will charge for all of its private branch exchanges at least \$5.50 per month. The ordinance fixes

no rate for private branch exchanges, and the Knoxville case is authority for holding the company is entitled to charge a reasonable price for service such as this.

The depositions taken at Toledo and the other cities all show the rate for private branch exchanges to be from \$5.50 to \$10.50 per month. (Rec. 1558, 1587, 1590, 1611.)

As to the trunk lines leading to private branch exchanges the company charges all manner of rates, but generally \$7.50. We, therefore, assume that they treat the trunk lines as subscribers and have, therefore, placed a rental on them of \$5.50 per line, which is the ordinance rate.

The pay station proposition requires more discussion. The company has something over 1,400 pay stations. Mr. Jagoe (Record, p. 651) said that some of the pay stations cost \$9.05. Mr. Smith (page 420) showed the rate on pay stations in New Orleans to be \$6.50 per month guaranteed. Mr. Warren (page 1104) showed that there were 560 direct line pay stations and 851 party line pay stations. He also showed the number of business and residence pay stations. Mr. Warren gave some interesting facts concerning pay stations. (Record 1063, 1064.) For instance, in December, 1905, the company had 565 pay stations (all business), and 5,990 actual subscribers. In September, 1907, it had 1,861 pay stations (mostly residence), and 5,600 actual subscribers. In other words there was a total gain in subscribers between the two months of nearly 1,000, and yet the earnings on these two classes of telephones for the month of September, 1907, were \$395.88 less than they were in December, 1905, and this too, notwithstanding the fact that in March, 1907, the rates on regular subscribers had been

increased. These facts detailed by Mr. Warren, taken in connection with Mr. Settle's statement (page 1000), wherein he showed that for many of the residence pay stations no receipts whatever were had, and that the average receipts were about 30 cents per month (which statement is not denied), the reason for this falling off in receipts can be easily determined. We ask Mr. Smith to produce the receipts from the pay stations, but he declined to do so. (Record, p. 423.)

The position we take in regard to a pay station subscriber is that he is and should be on the same footing as any other subscriber; that if the company desires to install that class of telephone, or any other class of telephone not named in the ordinance and charge therefor a rate less than the ordinance rate, it is discriminating and necessarily violating the law. Moreover, it must be assumed that the company will charge to every subscriber at least as much as the rates named in the ordinance. In the Knoxville Water case this very question was discussed in connection with the discount the company was in the habit of allowing to its customers. It was claimed that in determining the amount which would be earned under the ordinance, a 5 per cent discount for prompt payment should be taken into consideration. The Court said:

"The fallacy in the process employed by the Master consisted in substance in assuming that the ordinance rates would be subject to a discount for prompt payment. The company it is true, might, if it chose, allow such a discount from the ordinance rates, but the ordinance required no discount from the rates established by it, and the company, therefore, was bound to offer none. If it stood upon the letter of the ordinance, as it had the right to do, and exacted from the consumers the full charges prescribed by the ordi-

nance, the amount which would have been realized would have been over \$4,000.00 more than that found by the Master, or a net income of not less than \$40,000.00."

So in the case at bar, if the company stands on the letter of the ordinance and charges all subscribers alike at the rates fixed by the ordinance, as it has the right to do, then it will certainly earn on these pay stations the rates shown in Mr. Warren's exhibit.

It is self-evident that a telephone company cannot be permitted to require one set of subscribers to pay a high rate in order to make up losses which it may sustain on a class of subscribers who are charged a lower rate. This is especially true where the company is operated under rates established by a rate-making body. We, therefore, submit that the assumption must be indulged in that all subscribers will be charged at least as much as the rates fixed in the ordinance.

Because certain business subscribers have a pay station device attached to their telephone instrument does not do away with the fact that they have a business direct telephone or a business party telephone, as the case may be, and the same is true of residence telephones. Primarily these subscribers fall under the classification named in the ordinance and are so designated by Mr. Smith. A pay station is merely a device for collecting the rent, and does not alter the classification of the service. If it be contended that the pay station subscribers should not pay the ordinance rate, then their telephones should be removed. If the company loses these pay station subscribers, it is practically certain to more than make them up with live, paying subscribers.

In so far as free telephones are concerned, appellee has no right to install free telephones. It simply means that the subscribers who pay regular rates are required to pay more for one service in order that some subscribers may not be required to pay anything.

Mr. Warren showed (Record, p. 1107), as the result of the classification made by him, and assuming that all the subscribers whose names appear in Mr. Smith's Exhibit No. 6 were to be charged the rates fixed by the ordinance according to the class of service which those subscribers were shown to have, then, the total exchange earnings (not including toll earnings) would have been \$327,283.43.

It will be remembered that the Court fixed the earnings at \$330,918.00. This finding of the Court included \$12,720.00, representing toll earnings. Deducting this item from the finding of the Court, the result will show \$318,198.00 representing exchange earnings as found by the Court, which is \$9,085.00 less than the exchange earnings would have been in the year 1908, had the rate ordinance been in force during that year.

It should be borne in mind that the evidence given by Mr. Warren in this respect is based on Mr. Smith's Exhibit No. 6, and is refuted nowhere in the record.

It should also be borne in mind that in order to ascertain what the earnings of appellee would have been for the year 1908 had the rate ordinance been in effect it is necessary to add to the above item of \$327,000.00 a sum representing the toll earnings of the Louisville exchange.

Appellee contends only 15 per cent of the toll earnings, viz., \$7,000.00 should be added. The Master held that all of the toll earnings, viz., \$50,000.00 should be

added. The Court held that only \$12,720.00 of the toll earnings should be added.

That expenses of conducting the toll department amounting to at least \$30,000.00 are paid by the Louisville exchange, is apparent. Therefore, if the Louisville exchange is not to lose money on account of the toll department, at least \$30,000.00 should be added to the above item of \$327,000.00 in order to ascertain what the exact earnings would be under the rate ordinance.

EXPENSES.

The appellee charged in its Bill of Complaint (Record, p. 14), that its expenses for the year 1908 amounted to	\$239,710.48
In Mr. Smith's Exhibit No. 1 (Record, p. 474), he shows the expenses for the year 1908 to have been	227,495.66
The two accountants found the expenses for the year 1908 to have been (Record, p. 746)	217,395.53
The Master found the expenses to have been (Record, p. 83)	216,363.07

In Mr. Warren's Exhibits Nos. 9, 10, 11 and 12 (Record, p. 1122), he starts with the expense item above mentioned, viz., \$217,395.53 for the year 1908 as found by the accountants, and then made certain deductions therefrom representing items which were not properly expenses of the Louisville exchange. These items so deducted are explained by Mr. Warren beginning with page 1081 of the record. They are in a general way, taxes, insurance and expenses of conducting the toll department.

Taking up first the items of taxes and insurance:

Mr. Smith's Exhibit No. 1 (Record, p. 474) shows the amount of taxes, insurance and rentals paid on all prop-

erty, including that paid on the real estate and buildings. It will be remembered that the complainant treats its real estate as an outside operation and charges against the Louisville exchange, as a part of the operating expenses of the Louisville exchange, a certain sum as rent. It also charges against the Louisville exchange as a part of its operating expenses all the taxes and insurance which it pays on that real estate and on the buildings. (See Record, pp. 1083-1086, also Warren's Exhibit No. 8.)

As a result of this method of making charges against the Louisville exchange, appellee gets a rental equal to 8 per cent net on the book value of its property. If the taxes and insurance were paid out of this rent the company would earn about 6 per cent net on the book value of its real estate. (Record, pp. 1100-1101-1083). Inasmuch as the exchange is required to pay the taxes and insurance in addition to the rent it results that the Louisville exchange is paying appellee 8 per cent net on that book value. (See Record, pp. 1083-1084). The evidence shows that 4 1-2 to 5 1-2 per cent net is the amount which property owners usually receive for property of a similar nature. (Record, p. 973). The Master deducted from the expenses the amount paid as *taxes* on the *main exchange*, whereas he should have deducted the amount of *taxes* and *insurance* on *all four exchanges*. (Record, p. 80).

The record shows that the appellee paid insurance on these buildings and real property for the year 1908 amounting to \$1,308.30. (See Warren's Exhibit No. 8, Record, p. 1122). There should, therefore, be deducted from the amount found by the Master the additional sum of \$1,308.30.

Included in the \$216,363.07 which the Master found to be the expenses of the exchange is an item representing instrument expense. This item for the year 1908 amounted to \$13,722.52, and represents the rental paid by the appellee to the American Telephone and Telegraph Company for the use of the transmitter and receiver, (Record, p. 72). The transmitter is the round biscuit-shaped part of the telephone apparatus into which the subscriber talks. The receiver is the gutta-percha apparatus which hangs on the hook of the desk set and which is placed to the ear.

Mr. Polk, Mr. Crumb, and Mr. Smith, show that about 10,000 of these instruments are used by the appellee in Louisville; that these instruments last about eight years and cost about \$2.00 per instrument. Mr. Polk and Mr. Crumb say that these instruments, or instruments as good or better, can be purchased in the open market for \$2.00 each (Record, p. 1506). The instruments, therefore, on which the appellee is paying out \$13,722.52 per year can be purchased for \$20,000.00. The Louisville exchange is therefore being compelled to pay out over 65 per cent per year on the value of these instruments (\$13,000.00 being 65 per cent of \$20,000.00). If the receiver and transmitter last eight years, about 12 per cent depreciation should be allowed. But grant that 14 per cent depreciation should be allowed. The owner of the instruments, the American Company, should not be entitled to earn over 6 per cent thereon. This makes a total of 20 per cent. If, therefore, the appellee were to purchase these instruments outright, it could do so for \$20,000.00, and if it be allowed to earn 20 per cent thereon the amount of instrument expense which would then be charged

against the Louisville exchange would be \$4,000.00 instead of \$13,722.52. It, therefore, seems that the appellee is charging \$9,000.00 per year as instrument expense more than it should charge against the Louisville exchange. This \$9,000.00 should, therefore, be deducted from the total expense item as found by the Master.

In this connection it should be borne in mind that the American Telephone and Telegraph Company owns the transmitter and receiver; that the American Telephone and Telegraph Company owns the appellee and can, of course, compel it to pay whatever price it demands for the use of these transmitters and receivers. (Record, p. 445).

Mr. Smith tried to make it appear that the instrument rental paid entitles it to certain engineering services, and advice generally, from the American Telephone Company. The record shows that the appellee does its own engineering, even to the extent of matters connected with the installing of switchboards, if Mr. Caldwell, the president is to be believed. (See Record, p. 835).

The Chicago Telephone Report considered the question of instrument rental as charged against the Bell Company by the American Telephone Company and reported as follows (Record, p. 446):

"Taking an average rate of 12 per cent depreciation, making due allowance for the scrap value, and allowing 8 1-2 per cent for interest, insurance and taxes (of which 2 1-2 per cent is allowed for the latter two items), and 3 1-2 per cent for maintenance, makes a total annual item of cost to the American Bell Telephone Company for furnishing these pieces of apparatus to the Chicago Telephone Company that amounts to 24 per cent of their first value of \$3.00

per set. As the Chicago Telephone Co. in the Chicago business, has now (January 1, 1907), more than 130,000 telephones in actual use, we assume that our estimate of an average of 150,000 complete telephone sets in use and in stock during 1906, is approximately correct, though we have not had time to verify this figure. At \$3.00 per set, the total value of these 150,000 sets is \$450,000.00, and 24 per cent of this amount is \$108,000.00, which is a fair payment to the American Bell Telephone Company for furnishing these instruments. This leaves a balance of approximately \$174,000.00."

A report was made by the New Orleans Board of Trade on the operations of the company of appellee in New Orleans. That report is filed by Mr. Smith as a part of his deposition and on pages 64 and 65 of that report (Record, p. 446) appears the following language:

"It may be stated, as a general proposition, that the rental charged for the instruments by the American T. & T. Co., is about twice the amount that would suffice to give it a fair return. In 1906, the amount paid for instrument rental was \$26,418.76 on a total average number of 12,339 instruments, or a little more than \$2.14 per instrument. Admitting that the total annual item of cost to the American T. & T. Co. for furnishing these telephone sets, each containing a transmitter, receiver and induction coil, is 33 1-3 per cent of their original cost, which is stated to be \$3.00, it will be seen that under this contract something in excess of \$14,000 is paid by the Cumberland Company, over and above what may be strictly considered as a fair rental charge."

Another item of expense included in the \$216,363.07 found by the Master is an item representing the revenue which the company would receive were it to charge for its free telephones. In other words, appellee has a great many telephones from which it derives no revenue. On

its books it places a credit representing what the revenue from these telephones would be were the company to charge therefor. To offset this item it charges a corresponding amount as a part of its expenses. Mr. Warren (Record, pp. 201-1096) explained this charge and what he there says is nowhere denied. If, therefore, the appellee has 100 free telephones (and Mr. Smith's Exhibit No. 6 shows a great many more than that) then the appellee's books show that it had collected a rental on these free telephones of say \$500.00 per month, or \$6,000.00 per year. To offset this amount it would charge on its books \$6,000.00 as an expense item representing what it would have received had it charged the regular rental for the free telephones. So far as showing what the earnings and expenses were for the year 1908 under the old rate, this item is immaterial, but with the rate ordinance in force under which appellee will be entitled to charge every subscriber the rate fixed in the ordinance, this item will make a very considerable difference.

It must be assumed that when the appellee operates under the rate ordinance it can charge all of its subscribers alike and furnish no free telephones and it will certainly not be entitled to charge as part of its expenses a sum of money which it did not expend, but which merely offsets earnings which it might have made had it charged the free users of telephone service regular rates.

I have not taken time to go over Mr. Smith's Exhibit No. 6 to determine how many telephones are furnished by appellee free of charge, nor the class of service furnished such telephone users. There are certainly more than one hundred such users.

The Master disregarded all the foregoing items I assume because a consideration of them was not essential to decide that the ordinance rate was valid.

Exceptions, however, were filed to the findings of the Master in respect to all of these items (Record, pp. 198-203), which exceptions were overruled by the Court. If these items are proper deductions from the expenses, and I submit that the uncontroverted evidence sustains the facts as herein stated, then there should be deducted from the expenses as found by the Master the following items:

Insurance	\$ 1,308.30
Instrument expenses	9,722.52
Expenses charged up on account of free telephones	_____
Total at least	\$11,030.82

Deducting the total of the above items from the total expenses as found by the Master, viz., \$216,363.07, leaves a balance of \$205,333.00 as the total expenses incurred by the complainant in conducting its plant in the City of Louisville for the year 1908.

Items representing identically the same character of expenses in substantially the same amounts, should be deducted for the years 1905, 1906 and 1907.

Another deduction made by Mr. Warren from the expenses as found by the accountants, viz., \$217,000.00 represented the expenses of conducting the toll department. This item is discussed at pages 131 to 147 and also pages 35 to 38 of this brief.

Both the Master and the lower Court allowed these items to remain a part of the expenses of the exchange, and added to the earnings a sum to offset these expenses—

the Master adding all of the local toll earnings, the Court \$12,000.00 of these earnings. It should be remembered that the toll receipts on *outgoing* messages was (Record, pp. 75-79) \$50,000.00

Assuming that the toll receipts on *incoming* messages is equally as large, viz. 50,000.00
The toll receipts on American Telephone Company's business was (see this brief, p. 140).. 40,000.00

Then the result will show total receipts by the Louisville exchange on the toll department of \$140,000.00

The lower Court only allowed to the Louisville exchange as its portion of those earnings and as representing its services and expenditure on account of appellee's toll department \$12,000.00
On account of American Telephone business... 3,200.00

Total \$15,200.00

It has been shown that the expenses charged against the exchange to conduct the toll department is (see this brief, p. 143).....\$ 30,000.00
Loss to Louisville exchange on toll business... 14,800.00
Clear profit to appellee on toll business\$124,800.00

No wonder Mr. Munster, the accountant who examined the books for the Board of Trade, said in his report (Record, p. 453) :

"My opinion is that the most productive part of the company's business is the toll line."

The Master found that the toll earnings were due solely to the existence of the exchange (Record, p. 78), and if

such is the case then it is fair to consider the receipts from both the outgoing and incoming messages.

It is immaterial whether these items be considered in connection with the earnings or expenses. Certainly some account should be taken of them. The City insists on the following treatment of the toll department:

A: The Master's findings were logical and should be sustained. If so, then:

All of the receipts on *outgoing* messages over toll lines at Louisville should be credited to the earnings of the Louisville exchange.

All of the expenses of conducting the toll department at Louisville should be borne by the Louisville exchange.

The value of the toll property should be added to the value of the exchange property and the appellee allowed to earn a fair dividend thereon.

B: If the Master is not to be sustained then one of the following two courses should be pursued:

One. Credit should be given the Louisville exchange on account of toll earnings to the extent of at least \$30,000.00 instead of \$12,000.00 which the Court allowed. This \$30,000.00 does not exceed the amount the Louisville exchange is compelled to expend each year in conducting the business of the toll department. If this course is adopted, then the expenses of the toll department should be borne by the Louisville exchange, but the value of the toll lines should not be included as a part of the value of the plant.

Two. The toll department should be treated as a separate and distinct property; none of the earnings should be credited to the Louisville exchange; and there should

be deducted from the expenses at least \$30,000.00, which item represents the actual amount of expenses of the toll department, and which amount is paid out every year and charged as expenses of the Louisville exchange. If the toll department is treated in this manner of course the value of the toll department should not be added to the value of the plant.

The following figures show the alternative methods of treating the expenses of appellee for the year 1908, the adoption of any one of which will be satisfactory to the City:

Expenses found by the Master.....	\$216,363.07
Insurance on real estate	\$ 1,308.30
Excess instrument expense	9,722.52
Expenses charged on account of free telephone	_____
Total	<u>\$ 11,030.82</u>
Balance representing actual expenses	\$205,332.25

If the Court is to adopt the plan denominated "A" on the preceding page, then the following will be the result:

Earnings as found by the Master, including all toll earnings	\$369,081.00
Expenses as shown above	<u>205,332.52</u>
Net earnings	\$163,748.48

Twelve per cent on the value of the plant, in- cluding toll lines, as found by the Master namely, \$1,355,878.00	\$162,700.00
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Balance over and above twelve per cent on value of plant	\$ 1,048.00
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If plan denominated "B One" is adopted, then the following figures will result:

Exchange earnings as found by the Master (toll earnings eliminated)	\$318,000.00
Portion of toll earnings, representing actual expenses paid by the exchange	30,000.00
Total earnings	\$348,000.00
Expenses (toll and exchange)	205,332.25
Net earnings	\$142,667.75

Eleven per cent on the value of plant, not including toll lines, namely, \$1,243,011.97... \$136,730.00

Balance over and above eleven per cent \$ 5,937.00

If the plan denominated "B Two" be adopted, then the following figures will result:

Exchange earnings as found by the Master (toll earnings eliminated)	\$318,000.00
Total expenses of conducting both exchange and toll department	\$205,332.25
Deduct amount representing expenses of toll department	\$ 30,000.00
Total expenses of exchange	\$175,332.25
Net earnings	\$142,667.00

Eleven per cent of the value of plant as found
by Master, not including toll lines, namely,
\$1,243,011.97 \$136,730.00

Amount in excess of eleven per cent \$ 5,937.00

As shown in this brief (p. 153), the actual exchange earnings for the year 1908, had the rate ordinance been in force would have been \$327,000.00 or \$9,000.00 in excess of what they were found to be under the old rates.

DEPRECIATION.

This record discloses a most extensive discussion of the question of depreciation.

As I understand the question it simply means that a telephone plant, or a railroad or a factory or any character of enterprise which uses personal property or fixtures in conducting its business, finds it necessary every year to repair and renew parts of its property. It is, of course, incumbent on the managers of such plants to provide out of its earnings each year a fund which, together with its accumulations, will be sufficient to replace and renew worn out parts of its plant. A simple illustration can be made in connection with an engine used by a water company. If such an engine costs \$100,000.00 and lasts twenty-five years, then the company should set aside a sufficient percentage of the \$100,000.00 each year which, together with its accumulations, will purchase a new engine at the end of twenty-five years. It would not be necessary to set aside four per cent each year or \$4,000.00, because if such sum were set aside it would be found that the amount plus the accumulations would far exceed \$100,000.00 in twenty-five years. Just what amount should be set aside I do not know, but it should certainly not be four per cent.

This I conceive to be the general principle governing depreciation.

Public service and industrial concerns seem to have two methods of treating depreciation.

First. One is to set aside a sum each year and keep it separate and distinct from its other assets and which is to represent the depreciation in the value of a plant due to wear and tear, and which sum is to be used immediately or ultimately in replacing parts of the plant.

Second. Other concerns (and railroad and telephone property seem to be in the number) have learned that a given plant after being in operation for fifteen or twenty years will require year in and year out about the same amount of money to replace and reconstruct the parts as they wear out. Such concerns accordingly set no sum aside for depreciation, but simply charge to expenses each year the amount made necessary to maintain and reconstruct the property.

The evidence shows beyond a doubt that the appellee has been and is pursuing the second course.

There is a great deal said by the witnesses concerning maintenance, reconstruction and depreciation. Appellee attempts to show that maintenance is the ordinary current repairs of the property and that reconstruction is the wholesale repairs such as removing a switch-board and putting in a new switch-board, tearing down one line of poles and putting in another line of poles, etc.

After all the proof was taken the Master requested that the deposition of Mr. Caldwell, the president of the company, be re-taken in order that he might have Mr. Caldwell explain more in detail the appellee's attitude concerning depreciation. In that deposition the Master questioned Mr. Caldwell closely and among other things elicited the following proof (Record, p. 841) :

"Now then the distinction between maintenance and reconstruction is more or less shadowy?

"A. It is."

Again Mr. Caldwell (Record, p. 840) said :

"Q. 33. Is this item of depreciation an expense of conducting the business?

"A. It undoubtedly is.

"Q. 34. To what should be charged the expense of reconstruction?

"A. It should be charged to repairs."

The lower Court found that reconstruction and depreciation are interchangeable terms. In this connection the lower Court used the following language (Record, p. 1634) :

"It is apparent from the record that persons in the telephone business use the words 'reconstruction' and 'depreciation' almost if not quite interchangeably, so far as money spent or to be spent is concerned. In their art the two things are substantially the same from that standpoint."

The Master found that the plant was worth \$1,243,000.00; and that the amounts expended for the four years for maintenance were as follows (Record, p. 72) :

1905	\$49,819.14
1906	52,796.93
1907	65,616.31
1908	54,705.91

The Master also found that the amounts expended by appellee in reconstruction work for the four years were as follows :

1905	\$41,051.02
1906	40,626.07
1907	41,895.10
1908	31,450.07

The Master showed in his report that the total of the above two items represents 7 per cent of the value of the plant and he reached the conclusion that if a plant had been in operation for more than twenty years, and if the last four years of that period showed that 7 per cent was all that was required for maintenance and reconstruction, then it was fair to assume that 7 per cent was a sufficient sum for all time to maintain and reconstruct the property. In this connection the Master said (Record, p. 91) :

"I think it is reasonable and fair to assume that the amounts actually expended by complainant during 1905, 1906, 1907 and 1908 and to March 6, 1909—made, as they were, when this or similar litigation was not contemplated—indicate more clearly than opinions of witnesses what expenditures were necessary to properly repair, maintain and reconstruct the plant. The plant was acquired in 1899, and complainant took care of and maintained the plant up to 1905 just as it has done since that time.

"In that part of the report where the cost of the plant was considered, reference was made to a questionable entry in the books of the Ohio Valley Company. It appeared that that company paid dividends on its capital stock, maintained and reconstructed its plant from year to year out of exchange earnings during a period of eight or nine years. At the end of each fiscal year the Ohio Valley Company wrote off from its 'Construction' Account, and passed to 'Depreciation' an amount aggregating \$135,505.70.

"Complainant attacks those bookkeeping entries vigorously and in its construction account it has reversed the entries made by the Ohio Valley Company *supra*, and that aggregate item of \$135,505.70 appears as an integral part of the cost of complainant's plant immediately after it was purchased from the Ohio Valley Company in 1899.

"As to the correctness of this addition of \$135,505.70 to construction account, and therefore to the cost account of the plant, its expert accountant, Mr.

Wilkinson, on page 13 of his report, says: 'No such charge for depreciation was called for at all. *The amount actually expended by the Ohio Valley Telephone Company upon the up-keep of its telephone plant, was ample to provide for all reconstruction.*'

"This argument, when applied to the claim of complainant for an additional allowance out of earnings for 'incomplete depreciation' over and above the annual outlay for maintenance and reconstruction, is conclusive. In further support of the justness of my position, I may refer again to the testimony of complainant's witnesses who say that the physical condition of the plant is first class in every respect. (Wilkinson's Report, page 26.) (Smith and Caldwell.)"

It will be my purpose in the following pages to show that the Master was correct in his findings, and that over a period of twenty years 7 per cent on the value of the appellee's plant at Louisville had been ample to maintain and reconstruct all parts of the plant as they became useless from wear and tear.

I will also show that over appellee's entire system extending from the Ohio River to the Gulf of Mexico, 7 per cent on the value of its entire plant has been ample to maintain and reconstruct that plant.

I will also show that the American Telephone & Telegraph Company, which owns all of the Bell operating companies in the United States, has found after an experience of thirty-six years that 7 per cent is ample year in and year out to maintain and reconstruct all parts of a telephone plant.

I first call attention to the theory of depreciation as laid down by Mr. Smith in his direct examination.

On page 227 he told what depreciation was and on page 228 he said: "This depreciation would partly be spent from year to year and part of it would go into the

reserve account." On page 229 he said that this depreciation fund should be reinvested and should earn interest. On page 229 occurs this question and answer:

"Q. In other words, to get along on as low percentage as 7 1-2 per cent of the original cost of the property, you must allow that money to accumulate interest, otherwise you would have to use a larger per cent for depreciation?

"A. Exactly."

On page 233 occurs this question and answer:

"Q. Now it very often happens, I assume, that you use more than 7 1-2 per cent in one year in reconstruction?

"A. Yes."

I will show a little later that over a period of ten years last the largest percentage used for reconstruction in any one year was in the year 1900 when it was 3 7 10 per cent. For the year 1908 it was 1 1-10 per cent.

Mr. Caldwell on page 511 said that a 7 1-2 per cent depreciation fund was required. Mr. Hume placed the depreciation fund at 7 1-2 per cent. (Record, p. 680.)

Mr. Smith (page 235) said the company had never set aside any depreciation fund. Mr. Caldwell said the same thing. (Record, p. 840.) See also Hume's deposition (Record, p. 698).

If it be true as asserted by the appellee's witnesses that there comes a time when the plant wears out in its entirety, then such period will certainly arrive within thirty years after the construction of the plant. Capt. Gifford showed that this plant was constructed in 1879. (Record, p. 957.) In 1890 it was a well developed plant. Since 1900 it has been operated by the appellee. Mr.

Hume said that the amounts expended on reconstruction for the last years of the period are greater than the amounts expended during the first years (Record, p. 686), and yet the amount expended in 1908 in reconstruction, according to Mr. Smith (page 217) was only \$19,000.00. Mr. Smith's Exhibit No. 2 (Record, p. 475) shows that since 1904 the new construction has cost only \$155,000.00, so that practically the entire plant is now over five years old.

If we assume that Mr. Smith's figures representing the cost of the plant are correct, then beginning with 1905, the cost of the plant represented an expenditure of \$1,532,657.90 and the amount expended for reconstruction \$41,051.02 (Record, p. 72), a calculation will show for that year the amount expended on reconstruction was 2 6-10 per cent on the cost of the plant. The following table shows for 1905, 1906, 1907 and 1908 the cost of the plant as shown by Mr. Smith, the amount expended for reconstruction and the percentage which the reconstruction bears to the cost of the plant:

	Cost.	Reconstruction.	Percentage.
1905	\$1,532,657.90	\$41,051.02	.02.67
1906	1,593,623.91	40,626.07	.02.54
1907	1,682,905.41	41,895.10	.02.43
1908	1,704,397.09	19,535.72	.02.14
		Average,	.02.19

I do not believe the plant cost what Mr. Smith said it cost at the beginning of 1905. There is no way of ascertaining what it did cost at the beginning of 1905 except

Note. The figures representing the cost of the plant as above indicated are shown on Mr. Smith's Exhibit No. 2. (Record, p. 475.) The figures showing the amount expended for reconstruction are shown in the joint report, except for 1908 which is shown by Mr. Smith, p. 217.

by making an estimate based on the number of subscribers. Between 1900 and 1905 the company gained 5,500 subscribers. If we assume that the plant was worth \$450,000 when purchased, then by adding \$100,000 to Plant Account for each subscriber gained (Mr. Crumb's estimate, p. 875) or \$550,000.00, the plant was worth in 1905 \$1,000,000.00. During the year 1905 120 subscribers were gained, which, at \$100.00 per subscriber, would make a total of \$1,012,000.00. In 1906 about 1,000 subscribers were gained, which, for the beginning of 1907, would make a total investment of \$1,112,000.00. During 1907 more subscribers were gained, but during 1908 still more were lost, so that for the years 1907 and 1908 I have taken \$1,112,100.00 as representing the value of the plant, and have prepared a table similar to the one above showing the percentage of reconstruction to the estimated value of the plant based on the theory above detailed. The table is as follows:

	Plant.	Reconstruction.	Percentage.
1905	\$1,000,000.00	\$41,051.02	.04.10
1906	1,012,100.00	40,626.07	.04.01
1907	1,112,100.00	41,895.10	.03.76
1908	1,112,100.00	19,535.72	.01.75
		Average,	.03.40

I have prepared the following table based on the Master's valuation of the plant and toll lines from 1900 to 1908 inclusive. This table shows the actual amount expended for both maintenance and reconstruction each year

as shown by the records and also shows the percentage which such expenditure bears to the value of the plant :

Year.	Value of exchange and toll lines.	Maintenance and reconstruction.	Per cent.
1900	\$582,985.87	\$50,000	.08
1901	722,000.00	68,000	.09
1902	875,000.00	53,000	.06
1903	1,067,000.00	51,630	.05
1904	1,207,000.00	66,000	.06
1905	1,312,000.00	90,800	.07
1906	1,347,000.00	93,400	.07
1907	1,355,878.00	107,500	.08
1908	1,355,878.00	86,000	.06
Average, 7 per cent.			

The above table is based on what the Master said the plant had cost. If the appellee's own figures on valuation of plant be taken, and the amounts expended for maintenance and reconstruction over a period of ten years be based thereon, the following facts will be shown :

Year.	Value of exchange and toll lines.	Maintenance and reconstruction.	Per cent.
1900	\$638,196.74	\$50,000	.07
1901	804,000.00	68,000	.08
1902	982,000.00	53,000	.05
1903	1,200,000.00	51,630	.04
1904	1,363,000.00	66,000	.05
1905	1,494,000.00	90,800	.06
1906	1,554,000.00	93,400	.06
1907	1,670,000.00	107,500	.06
1908	1,700,000.00	86,000	.05
Average, 5 4-5 per cent.			

In addition to the facts above detailed the record fortunately has in it other facts which should be conclusive of this question.

Mr. Caldwell in his second deposition filed as Exhibit A with his deposition the annual report of the directors

of the American Telephone & Telegraph Company to the stockholders. This annual report contains a statement of the plant account for the years 1908 and 1909 and the amount expended for those two years for maintenance and reconstruction. (Record, p. 846.) On page 7 of this report (Record 849) will be found the statement in question. It will be noted that this statement includes only the operating companies controlled by the American Company, such as appellee, and does not include the long distance lines operated exclusively by the American Company. It will also be noted that the amount representing the expenditures for maintenance and reconstruction is entitled "Maintenance and depreciation." However, on page 8 of the same report, this item is more fully described as "Current repairs and maintenance of property and *provision for depreciation*." As maintenance and reconstruction are not separated in this report it is necessary to determine how much of the sum set opposite this item represents maintenance and how much reconstruction.

It will be remembered that no separation was made between reconstruction and maintenance for the years 1900 to 1904 inclusive. During those years all maintenance and reconstruction work was charged as expenses of the plant under the head of maintenance. (Record, p. 338.)

It is, therefore, impossible to tell accurately how much of the maintenance charges for those years was used in reconstruction work. The only way to approximate the amount expended during those years for reconstruction is to ascertain the ratio that maintenance and reconstruction bore to the total of both for each of the years, 1905, 1906 and 1907 inclusive, as shown by the record and as indicated above. It will be remembered that those are the

only three years wherein appellee separated its maintenance from its reconstruction.

The joint report shows what the maintenance and what the reconstruction amounted to for those three years (Record, p. 72), and a calculation will show that 42 4-10 per cent of the total expenditure for maintenance and reconstruction represented reconstruction and that 57 6-10 per cent of the total expenditure represented maintenance.

In determining how much was expended for maintenance and reconstruction by the American Telephone Co., I have adopted the percentage above indicated, viz., 42 4-10 per cent representing reconstruction and 57 6-10 per cent representing maintenance.

Therefore, of the \$37,204,300.00 representing maintenance and reconstruction for the year 1908, 42 4-10 per cent thereof represented reconstruction, and of the \$42,418,000.00 representing maintenance and reconstruction for the year 1909, 42 4-10 per cent represented reconstruction. The amount invested in the subsidiary plants for the year 1908 was \$475,034,000.00 and for 1909 was \$501,757,100.00. I have placed below a table showing the plant account for each of these years, showing 42 4-10 per cent of the total items representing maintenance and reconstruction for each of the two years and the percentage which this item bears to the amount invested in the telephone plant:

Year.	Plant.	Reconstruction.	Percentage.
1908 . .	\$475,034,000.00	\$15,774,500.80	.03-32
1909 . .	501,757,100.00	17,985,232.00	.03-58

This report shows that this company began business in 1876. It would, therefore, seem reasonable to assume that

at the end of thirty-three years the amount actually expended in reconstruction would be a fair amount to set aside as the annual expenditure for reconstruction purposes for any telephone plant.

Again, the total of maintenance and reconstruction as appears on page 7 of the above report, is about 8 per cent of the value of the plant.

But this is not all. Mr. Caldwell has filed in this case his annual report to his stockholders for the years 1906, 1907, 1908 and 1909. (Record, pp. 561, 567 and 585.) In those reports under the heading "Expenses" he shows one gross sum as the amount expended for maintenance and reconstruction. He also shows the amount invested in the plant for each of those years. I have used the same basis of calculation for preparing another table, namely, assuming that 42 4-10 per cent of the amount expended for maintenance and reconstruction was expended for reconstruction, and have then ascertained the percentage which that amount bore to the plant account for the particular year in question. Here is the table:

Year.	Plant.	Reconstruction.	Percentage.
1906	\$22,724,781.24	\$801,076.17	.03-52
1907	23,895,126.87	832,020.46	.03-48
1908	24,381,297.64	819,639.26	.03-36
1909	26,042,429.91	861,083.09	.03-36

It, therefore, seems that the Cumberland Company, which has been operating telephone plants over a large territory since 1886, finds at the end of over twenty-four years' experience that the actual amount required yearly for reconstruction is 3.4 per cent.

All the witnesses agree that the plant of the appellee is in excellent physical condition. (Wilkinson's Report, Record, p. 769.)

In Mr. Wilkinson's separate report (Record, p. 758), he said:

"From 1890 to 1899 inclusive the Ohio Valley Telephone Company had expended upon its telephone plant the total of \$511,675.66, or equal to an average of \$51,167.56 a year. This sum included all repairs, maintenance and reconstruction and in addition it included almost *all new aerial* construction.

"Not one dollar was added to reconstruction account on the books from 1890 to 1897. This actual expenditure which was all charged against earnings is equal to 10.39 per cent per annum of the cost of the plant as shown by the books."

Bearing in mind that Mr. Smith's Exhibit No. 2 shows that the aerial construction from 1899 to 1908 inclusive was in excess of \$560,000.00 (over one-half of what was expended during the entire period of nine years) it would certainly seem fair to assume that 3 3-10 per cent of the 10 3-10 per cent referred to by Mr. Wilkinson represented aerial construction. If this be a fair assumption, then during the ten years prior to the acquisition of the Ohio Valley plant, 7 per cent of the value of the plant was all that was needed to maintain and reconstruct the plant.

Finally, there is in this record one deposition given by the appellee's treasurer which shows beyond the peradventure of a doubt that the position taken by the Master and contended for by the City is the only logical conclusion of which the record will permit.

I refer to the deposition of Mr. Webb, treasurer of the company, and three exhibits filed by him with that deposition (see Record, p. 1580).

Those exhibits show for the year 1900 that \$42,115.40 was set aside for depreciation which amount appeared in his statement as a part of the expenses, but not expended. Those exhibits show that for the year 1901 the complainant set aside \$39,850.00 for depreciation which amount was included as a part of the expenses for that year, but not expended. (Record, p. 1582:394.)

Now, what has become of this \$80,000.00 which was set aside in 1900 and 1901 to take care of depreciation? Was it expended in 1907 and 1908? If so, then no part of appellee's expense for reconstruction for those years should have been charged against Louisville. In reality appellee did not set aside \$80,000.00 in 1900 and 1901. There was no occasion for setting aside any such sum. It maintained its property during those two years just as it has maintained it ever since, the cost of such maintenance being charged to expenses. Those two items, aggregating \$80,000 are simply bookkeeping items.

I have already shown that according to this deposition of Mr. Webb appellee earned during year 1900, 19 per cent on the value of its plant and during the year 1901, 16 per cent on the value of its plant. (See this Brief, p. 199.)

Now, if the appellee had continued to earn money from 1901 to 1908 as it did in 1900 and 1901 and had continued to set aside a part of its earnings for depreciation, it would now be in the attitude of having maintained its property in the highest state of repair for nine years, of having expended and charged up against the Louisville Exchange the cost of maintaining its property in this high state of repair, and in addition thereto having set aside out of earnings certainly 3 per cent on what it says its plant cost. We have prepared a table showing what those

items would amount to. This table is based on Mr. Smith's Exhibit No. 2.

1899	\$ 678,354	3 per cent	\$20,300
1900	845,293	actually set aside	42,115
1901	1,024,145	actually set aside	39,850
1902	1,237,615	3 per cent	37,000
1903	1,401,102	3 per cent	42,000
1904	1,532,657	3 per cent	46,000
1905	1,593,623	3 per cent	47,000
1906	1,682,905	3 per cent	50,000
1907	1,682,905	3 per cent	51,000
1908	1,700,045	3 per cent	51,000
			<hr/>
			\$426,265

Now, over a period of twenty years, there has been no occasion to set aside or use any such fund. No such fund has been set aside or used and no such fund will ever be needed. It is a bookkeeping device, pure and simple, and as Mr. Munster says is only made use of when regulations of rates are attempted. (Record, p. 451.)

The appellee would have the Court believe that the Master did not understand the question of depreciation.

As showing that the Master did understand the question of depreciation we call the Court's attention to the following question propounded by the Master to Mr. Caldwell (Record, p. 841). Mr. Caldwell's second deposition was taken specifically for the purpose of explaining what depreciation was.

The Master:

"Now these two amounts, that is, the amount first given as having been actually expended for maintenance, reconstruction and replacement, and the latter amount as being unexpended together, amount as he states it, to more than 10 per cent of the cost of the plant. Now, what I want you to explain is whether

or not in your judgment the 7 1-2 per cent claimed for depreciation ought to include the amount expended for maintenance?"

Mr. Caldwell then proceeds to say that the items of expenditure, for reconstruction and maintenance are so shadowy it was practically impossible to separate them. The Master certainly was impressed with the fact that they should not be separated, and that 7 per cent of the value of the plant was sufficient to take care of both maintenance and reconstruction.

Both Mr. Smith (Record, p. 239) and Mr. Caldwell (Record, p. 536) speak of the report made by Mr. Muster to the Board of Trade of Louisville in the highest terms. Mr. Caldwell approved that report. I had Mr. Smith read a part of that report which is as follows (Record, p. 451) :

"As it is claimed that the company's plants are now in prime condition and that all the subscribers' stations are equipped with the highest type instruments, it may be difficult to see why from 5.74 to 7.5 per cent of the original cost of the property should annually be contributed out of the earnings to cover wear and tear and decay, as proclaimed by telephone people, not in their statements to their stockholders or investors, but when the matter of franchise and rates for service is up for discussion."

It would, therefore, seem that Mr. Muster, who was employed by the Board of Trade, was impressed by the evidence which he gathered as was the Master.

The fact is, the amount of reconstruction required depends almost entirely on the amount expended in maintenance. If a company tightens up a bolt at one place, straightens up its poles at another place, and watches its switchboards carefully, and maintains the

plant in first-class condition, necessarily the reconstruction items will not be very large. All the witnesses say that the plant of appellee is well maintained. The cost of maintaining this plant appears in the items of expense under the head of "Maintenance." The subscribers should not be required to pay out large sums of money in the way of maintaining the property and then in addition pay into the coffers of the company excessive sums of money to be treated as surplus when it will never be required for reconstructing the plant. There may come a time when the switchboards will have to be replaced new throughout (though Mr. Jagoe on page 648 said that switchboards are indestructible), but there is no other part of the plant which year in and year out cannot be taken care of in the way of maintenance, representing in the main the same expenditure each year.

It is self-evident that all the protestations made by Mr. Caldwell and Mr. Smith and Mr. Hume that 7 1-2 per cent depreciation is based on past experience is fallacious. Past experience as shown by the books is exactly the converse of their contention.

Again, if the plant depreciates 7 1-2 per cent per year, then I submit that at the end of the year the plant is worth exactly 7 1-2 per cent less than it was at the beginning of the year. In other words, if the plant is worth \$1,000,000.00 at the beginning of the year, and depreciates 7 1-2 per cent a year, then at the end of the year it is worth only \$925,000.00. However, if \$20,000.00 of the \$75,000.00 which represents the 7 1-2 per cent is expended in reconstruction, then the plant should be represented on the books and should be actually worth \$945,000.00, and there should be \$55,000.00 in the depreciation fund. This

plan is worked out by Mr. Warren in his Exhibit No. 5 (Record, p. 1050). Mr. Warren in this exhibit takes the figures as they appear on the books representing the cost to the company and also the figures representing the reconstruction and shows that if this method were pursued then assuming that the company had set aside 7 1-2 per cent a year for depreciation, the plant would now be worth but little over \$1,000,000.00 and there would be over \$600,000.00 in the depreciation fund.

If the plan worked out by Mr. Warren on the book value of the plant were worked out on the actual value of the plant, an even more startling state of case would be shown.

The treatment of depreciation by the lower Court is confusing.

The Master found that over a period of years 7 per cent on the value of the plant had been ample to maintain and reconstruct the plant.

(It will be remembered that reconstruction and depreciation are the same as found both by the Master and by the lower Court. (See Brief, p. 167.)

The Court discussed the question of depreciation on pages 1630 to 1636 and also on page 1642 of the Record.

On page 1633 of the Record the lower Court used this language:

"The Master expressed his own conclusions as follows: 'In view of the foregoing, I find that the fair and reasonable amount or proportion of annual income of complainant that should be set aside as a substantial provision and allowance for depreciation of complainant's plant and property employed in its business in Louisville, and including everything except cash working capital and supplies, would be an

amount equal to 7 per cent of the value of the plant, as above limited, and that the amount expended annually for maintenance and reconstruction of the plant should be deducted from the 7 per cent fund.'

"It is obvious that the last clause of what he says makes it difficult to understand his findings, and especially difficult to reduce it to a percentage which will apply to the future. These difficulties, however, are somewhat moderated when we find that the Master himself appears to have figured depreciation upon the basis of about 7 per cent of his valuation of the property, and we shall go upon the idea that he meant to find that 7 per cent was proper. If any of the exceptions reach this finding, the question to be considered is, what proportion of the company's annual earnings shall, in the language of the Supreme Court, which we have just quoted, be set aside 'for making good the depreciation and replacing parts of the property when they come to the end of their life?' This provision is altogether apart from and beyond current repairs."

The Master found (Record, p. 90) that the average amount expended on maintenance and reconstruction per year for the years 1905 to 1908 inclusive was \$94,000.00.

The Master further found that this \$94,000.00 represented an expenditure of 7 per cent on the value of the plant.

Fifty-four thousand dollars was expended in the year 1908 for maintenance. (Record, p. 72).

The lower Court from its language on page 1633 seems to hold that appellee should be allowed to earn not only the \$54,000.00 which it expended in maintaining its property, as above shown, but also 7 per cent on the value of its plant as found by the Court (\$1,575,000.00).

If the Court intended to allow any such sum the result would be that appellee for the year 1908 would be entitled to charge as expenses against the plant \$164,000.00

(7 per cent on \$1,575,000.00, being \$110,250.00, to which should be added \$54,700.00 representing maintenance for that year). The fact is that for both maintenance and reconstruction for the year 1908 appellee only expended \$86,000.00. (Record, p. 72.)

As the evidence shows that an expenditure of 7 per cent on the value of the plant over a period of twenty years has maintained and reconstructed the plant and kept it in prime condition, the fallacy of the Court's conclusion in this respect is apparent. Had appellee set aside \$80,000.00 a year for ten years to represent incomplete depreciation, it would now have in its treasury \$800,000.00 and no incomplete depreciation to be taken care of.

The Court, however, does not seem to have meant what its language implied. For on page 1632, where he applied his conclusions to the value of the plant, earnings and expenses, he treats the 7 per cent as if it were intended to cover both maintenance and depreciation. Here is what the Court said:

"The Master found that the total operating expenses of the Company for 1908, though greatly less than those for the three preceding years, were \$216,363.07. *In this is included \$86,155.98, the amount which he finds was actually expended by the company for what he calls 'maintenance and reconstruction.'* He found the average amount spent for that purpose for the four years to be \$94,490.19. The company did not, therefore, spend in 1908 the average amount by \$8,334.21. *Depreciation calculated on the basis of 7 per cent on the Master's valuation of the plant, viz.: \$1,355,878.09 would call for \$94,911.46 per year, which is \$8,775.48 in excess of the amount actually expended on that account in 1908.* The Master finds that the net income on the company in 1908 was \$150,673.19, but when we deduct from the gross earnings as we find them, viz., \$330,926.38, the full amount of \$216,-

363.07, found by the Master to be the gross expenses, we find the apparent net income to be only \$114,563.07, which would be 6 7-17 per cent upon \$1,788,000, which we find to be the value of the company's property. Can we accept the \$114,563.31 as fairly representing the company's net earnings in 1908, the year always most favorable to the City, and upon which, therefore, we have based all our calculations? We conceive the answer to this question to depend upon the valuation of the plant and upon how we treat the matter of depreciation. While we shall soon come to the latter, we may so far anticipate it as to say that *if we shall find 7 per cent on the present value of the company's destructible property (which we have fixed at \$1,575,000.00) to be the proper provision for depreciation, the difference between that sum, viz., \$110,250.00 and the \$86,155.98, which was actually spent for depreciation in 1908, will be \$24,095.02, which would reduce the net earnings to \$90,468.29 equal to 5 10-17 per cent on the value of the company's entire property here. If we estimate the 7 per cent on the original cost of the plant as it was found by the Master, viz., \$1,506,531.21, we find the difference between \$105,457.19, the sum thus produced and the \$86,155.98 to be \$19,301.20. This would reduce the net earnings to \$96,262.11, which would be 5 6-17 per cent on the value of the company's property. Of course, the amount needed to restore the values lost by depreciation necessarily varies from year to year because some parts of the plant have shorter life than others."* (*Italics mine.*)

It is clear from the foregoing language that the Court adopted the views of the Master and found that 7 per cent on the value of the plant was all that was needed to maintain and reconstruct the property, and that maintaining and reconstructing the property included all sums which might be required on account of depreciation of any nature whatever.

That the question of depreciation is treated differently by different concerns is shown in Mr. Caldwell's deposition (p. 838) where, in discussing the subject, he said:

"As to how it may be treated, or how it may be kept, is a subject that will vary and has varied with different people in different lines of business."

In view of the above language of the President of the Company and of the foregoing facts it is apparent that appellee was, when it filed its Bill of Complaint, proceeding on the theory that it would require the same amount year by year to maintain and reconstruct its plant.

That such was the case is conclusively shown by the fact that for the years 1900, 1901, 1902, 1903 and 1904 it did not separate maintenance and reconstruction. (See Webb's Exhibits, Record p. 1580 Smith's Deposition, Record pp. 338, 394). For the years 1905, 1906 and 1907 it did separate reconstruction from maintenance, but in the year 1908 it returned to its former plan and did not separate maintenance from reconstruction. (See Record, p. 412). 408-338-719

TELEPHONE CONDITIONS IN OTHER CITIES.

In order that the Master might have before him for consideration the rates and data concerning telephone companies in other cities, depositions were taken in Toledo, Kansas City, St. Louis, Detroit, Cincinnati and Columbus. (See Record, pp. 1557 to 1613).

The witnesses all admit that Louisville is as favorably situated from a telephone standpoint as any of the cities named, and there is nothing in this record to show why comparisons are not logical and fair to the complainant,

except the mere statement of Mr. Caldwell that such is not the case. We submit that Mr. Caldwell's statement on the subject is but a creature of his imagination, and has no foundation in fact or in reason. If he wanted to break down the effect of these comparisons he should have stated facts showing why they should not be considered, and not merely contented himself with saying that they were not fair.

In the case of Interstate Commerce Commission vs. Southern Railway Co., 115 Fed. Rep. 741, the Court in discussing the weight to be given evidence touching the reasonableness of a rate, said:

"The criterion to which I think the greatest weight should be given are as follows: The opinion of expert witnesses, the effect of present rates on the growth and prosperity of Danville, and the cost of transportation as compared with the rates charged; *and the rates in force in numerous cities where the circumstances are as nearly similar as may be to those prevailing at Danville.*"

Judge Severens in the case of Interstate Commerce Commission vs. East Tennessee, Virginia & Georgia Railway, 85 Fed. 107, in speaking of such comparisons, said:

"Such comparisons are applied to every other kind of business, and the fact that there may be competition in said business will not be a controlling consideration, for the presumption would always be that the compensation charged for the service or thing is sufficient to be reasonable. The presumption is not, of course, a conclusive one, but would seem a fair one, in the absence of special circumstances."

It appears from the opinion of this Court in the case of Railroad Commission vs. Cumberland Telephone & Tele-

graph Company, 212 U. S. 419, that the appellee was then before this Court contending that its rates were lower than the rates of telephone companies in other sections of the country and for that reason should not be disturbed. In connection with the above contention this Court said:

"The complainant's charges for rates in Louisiana before the promulgation of the order No. 552 were also shown to be as low as those of any of the companies in the country, and lower than most of them."

That was a case in which no proof was taken by the Railroad Commission and the general statement of the officers of the company to the effect that its rates were lower was not controverted.

In the case at bar, however, the appellant has controverted those statements and has shown conclusively that the rates charged by appellee as compared with the rates charged in cities of a similar size are exorbitant. This being the fact appellee seeks to break down the effect of this comparison by having its president say that such comparisons are not fair.

For the purpose of comparing these rates I have prepared a table showing the facts in regard to these telephone companies in other cities. The population of each city is given, the number of subscribers, the number of instruments installed, the net rate charged for direct business telephones, and the amount which each subscriber to a business telephone pays for the privilege of being connected with each of the other subscribers in the exchange. Both Mr. Smith and Mr. Caldwell said that the more subscribers there were to an exchange the more it costs

per subscriber to operate the exchange (see Record, p. 416) and they said, moreover, that the more subscribers a telephone company had the more it was worth to each subscriber for the privilege of being a subscriber to that telephone system. In other words, their position is that if a telephone plant has 10,000 subscribers it is worth more to each subscriber connected with the exchange for the privilege of speaking to each of the other 9,999 subscribers, than it would be worth to him if there were only 5,000 subscribers connected with that exchange.

In Louisville, for instance, there are 9,000 subscribers. A subscriber having a direct business telephone is charged \$96.00 a year or \$90.00 net. He, therefore, pays one cent per year for the privilege of talking to each of the other subscribers to the exchange provided he desires so to do.

In Cincinnati there are 50,000 subscribers and a subscriber to a direct line in Cincinnati pays \$100.00 per year. The Cincinnati subscriber, therefore, pays two mills for the privilege of speaking to each of the other 49,999 subscribers to the exchange if he so desires. (Rec. 1558).

The table above referred to is as follows:

Population being according to 1910 census:

ST. LOUIS.

687,029 inhabitants.

Instruments.	Rate Per Year.	Rate Per Subscriber
Home 38,000	\$60.00	1 1-2 mills
Bell 49,000	72.00	1 1-2 mills

(Record, pp. 1583-1586).

KANSAS CITY.

248,381 inhabitants.

Home 25,000	\$60.00	2 mills
Bell 25,000	60.00	2 mills

(Record, pp. 1595-1601).

DETROIT.

465,766 inhabitants.

Home	12,500	\$60.00	4 mills
Bell	47,200	72.00	1 1-2 mills
(Record, pp. 1611-1613).			

COLUMBUS.

181,548 inhabitants.

Home	12,600	\$40.00	3 mills
Bell	14,000	54.00	3 4-5 mills
(Record, pp. 1589-1593).			

CINCINNATI.

364,463 inhabitants.

Bell	50,000	\$100.00	2 mills
(Record, p. 1558).			

TOLEDO.

168,497 inhabitants.

Home	14,500	\$48.00	3 mills
Bell	11,000	54.00	4 mills
(Record, p. 1561).			

LOUISVILLE.

223,928 inhabitants.

Bell	9,000	\$90.00	1 cent
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A comparison of the prevailing rates in other cities with the ordinance rates proves not only that the ordinance rates are fair and reasonable, but that appellee can earn a fair profit under them, and that they are far more favorable to the appellee than are the rates in effect in other cities. This is especially true if we take into consideration the argument of counsel that as the number

of subscribers increase so does the cost per telephone increase.

As an illustration compare the rates in two or three of the above named cities with the Louisville rates—the rates given being the yearly rentals:

COLUMBUS, OHIO.

181,548 inhabitants.

	No.	Phones.	Business Rates.		Residence Rates.	
			Single	Party	Single	Party
Home	12,600		\$40.00	\$34.00	\$24.00	\$18.00
Bell	14,000		54.00	36.00	27.00	18.00

TOLEDO, OHIO.

168,497 inhabitants.

	No.	Phones.	Business Rates.		Residence Rates.	
			Single	Party	Single	Party
Home	14,500		\$48.00	\$44.00	\$30.00	\$26.00
Bell	11,000		54.00	36.00	27.00	18.00

KANSAS CITY, MO.

248,381 inhabitants.

	No.	Phones.	Business Rates.		Residence Rates.	
			Single	Party	Single	Party
Home	25,000		\$60.00		\$36.00	
Bell	25,000		60.00 (Ordinance)		36.00 (Ordinance)	

LOUISVILLE, KY.

223,928 inhabitants.

	No.	Phones.	Ordinance Rates		Residence Rates.	
			Business Rates.		Single	Party
			Single	Party		
Bell	9,000		\$66.00	\$48.00	\$36.00	\$24.00

It will be observed that in none of the above cities does an independent company charge as much as the appellee is entitled to charge under the rate ordinance, and in only three of them does a Bell Company charge more than the rate fixed in the rate ordinance, viz., Detroit, St. Louis and Cincinnati. The Detroit Bell Company has 47,200 subscribers; the St. Louis Bell Company has 49,000 subscribers; and the Cincinnati Bell Company has 50,000 subscribers. The Kansas City Home Company has 25,000 subscribers, and charges at the rate of \$60.00 per year and pays 2 per cent of its gross receipts to the city. The Toledo Home Company with 14,500 subscribers charges \$48.00 per year as against \$66.00 here, pays 6 per cent dividend on its common stock and its common stock is quoted at 83. The St. Louis Home Company has 38,000 subscribers, charges \$60.00 per year as against \$66.00 here and pays a dividend on its common stock. The Columbus Home Company has 12,000 subscribers, charges \$40.00 per year, pays 5 per cent dividend on its common stock, and its common stock is quoted at 97. The Cincinnati Bell Company has 50,000 subscribers charges \$100.00 per year (only \$4.00 more per year than the Cumberland Company), pays 8 per cent dividend on its stock, and the stock is quoted at \$185.00.

I have not referred to the operations of the Louisville Home Telephone Company for the reason that the lower Court ruled out substantially all of the evidence bearing on the subject of the operations of that company. There is some evidence in the record however, and this I will proceed to call the Court's attention to.

The record shows that the Louisville Home Telephone Company in 1908 had 9938 telephones installed, (Record,

p. 1520); that all of them were direct lines (that is, no party lines); that the rates charged by the Home Telephone Company are \$48.00 a year for a business telephone and \$24.00 a year for a residence telephone. (Record, p. 1557); that on the foregoing rates it had paid 5 per cent interest on its bonded indebtedness and a dividend on its stock for the years 1905, 1906 and 1907 (Record, p. 1520); that for the year 1907 its income on its Louisville plant and three smaller plants surrounding Louisville was \$382,000.00; that its operating expenses for that year were \$204,000.00, giving a net income of \$134,000.00. (Rec. p. 1489).

The record shows that when the plant had 9,395 subscribers it had cost \$1,000,000.00. (Record, p. 1411)

The record shows that it has always paid the interest on its bonds and that its bonds represent the entire investment, its stock having been issued as a bonus with the bonds. (Record, p. 1013).

Mr. Wilhite, the Comptroller of the City, and Mr. Meriwhether, an expert accountant, examined the books of the Home Telephone Company and gave their depositions touching the earnings and operating expenses of that company. (Record, pp. 1458-1459). These depositions were quashed by the Master (Record, p. 103). The appellant filed exceptions to this action on the part of the Master and assigns the action on the part of the Master as error. (Record, p. 1653).

Appellant also sought to take the deposition of C. E. Archer, one of the officials of the Home Telephone Company, but on the objection of appellee's counsel, the lower Court refused to require Archer to give his deposition. (Record, p. 1458). This is also assigned as error. (Record, p. 1654).

If it be true that the comparison of rates is one of the means of determining whether or not ordinance rates are reasonable then it was certainly appropriate for the City to adduce evidence touching the operations of a plant of practically the same size and which was being conducted in the same City as that wherein the appellee was conducting its plant.

Additional Subscribers—Increased Cost.

It is contended by appellee that the cost of operating a telephone plant increases per subscriber in a geometrical ratio as the number of subscribers increase. These gentlemen all say that the general proposition applicable to all other classes of business, namely, that the larger the business the smaller amount it cost per unit to conduct the business does not apply to telephone exchanges. To a certain extent this is correct, but only in a limited sense. Mr. Polk and Mr. Crumb both discussed the logic of this proposition. They say (Polk, Record, 1439-1440 Crumb, pp. 908-909) that for a telephone company in a given community with an established business with 10,000 subscribers, the expense of conducting the business will probably be \$20.00 per subscriber; that if 3,000 or 5,000 or 7,000 more subscribers be added the expense of operating the telephone plant with the 15,000 or 17,000 subscribers will decrease per subscriber; that when a company has from 20,000 to 25,000 subscribers it will be necessary for it to install more complicated switch boards; that a larger percentage of those subscribers will be large users of telephone service and, therefore the expense of constructing the exchange will increase; that when the exchange and the plant is constructed for 25,000 subscribers and has

only 17,000 subscribers that the expense of conducting the business will decrease per subscriber until the 25,000 is reached.

Of course, if a telephone company with 10,000 subscribers has a gain of 5,000 additional subscribers all having direct business telephones, then the cost might increase. But that is not the way in which subscribers increase as shown by both Mr. Polk and Mr. Crumb. They say that the first subscribers to a telephone service are the large subscribers—the large business users; that when rates are lowered new subscribers are added; that these new subscribers come from small users and those who are not compelled to have a telephone—those who do not make much use of a telephone—but who will take it as a convenience if it is cheap. These subscribers who are so induced to take the service on account of lower rates are small users of telephones and there is a large volume of profit on such users. (Record, pp. 908-909).

The facts in this case as brought out by the evidence show that as the number of subscribers has increased there has been a gradual decrease in the expenses per subscriber of operating the plant.

Mr. Webb, the treasurer, shows in his exhibit, that the expenses for the year 1900 were \$173,000.00; (Record, p. 158) that the company had 4,888 telephones. The expense, therefore, on this basis was \$35.00 per subscriber. However, over \$40,000.00 of this \$173,000.00 was not expended, but was merely said to have been set aside to take care of incomplete depreciation. It has never been used and will never be used, and the Master found that there was no occasion for so setting it aside. Therefore, deducting \$40,000.00 from the \$173,000.00 leaves \$133,000.00

as the expenses for the year 1900. Based on 4,888 subscribers, the actual expense of the complainant for that year was \$27.30 per subscriber. For the year 1901, based on Mr. Webb's exhibit, the expense was \$25.00 per subscriber.

In 1905 there were 9,000 subscribers and the expense of operating the plant was \$227,000.00 or \$25.00 per subscriber.

In 1906 there were 10,000 subscribers and the expenses were \$233,000.00 or \$23.00 per subscriber.

In 1907 there were 10,400 subscribers and the expenses were \$246,000.00 or \$23.00 per subscriber.

In 1908 there were 10,000 subscribers and the expenses were \$216,000.00 or \$21.00 per subscriber.

The evidence, therefore shows overwhelmingly that the more subscribers the appellee has added to its telephone plant the less it has cost it per subscriber to pay the expenses of operating its telephone plant.

These calculations based on testimony given by appellee's officers, produce results—facts, that wholly refute the theoretical argument of counsel that the operating cost increases in a geometrical ratio as the list of subscribers grows.

These figures are actual—practical; not experimental or problematical. They show precisely what has taken place in Louisville from the operation of appellee's plant in this City.

It is said, however, that this Court, in the case of *Louisiana Railroad Commission vs. Cumberland Telephone & Telegraph Company*, 212 U. S. 414, held that the general proposition applicable to other classes of business, namely, that the larger the business the smaller

amount per unit it costs to conduct the business, does not apply to a telephone plant. The language used by this Court in that case was in substance that the evidence showed that the theory as promulgated by the appellee was correct. Now the evidence in that case consisted of the depositions of Mr. Caldwell, the President of the Cumberland Telephone Company, Mr. Smith, the Auditor of Company, and *Mr. Wilkinson*, a *certified accountant* for that company.

I have examined the record in that case and not one line of proof was taken by the Railroad Commission touching the operation of a telephone plant. The evidence of appellee's officers was accepted because uncontroverted.

The evidence in the case at bar—that is the general statements of Mr. Caldwell, Mr. Smith, *Mr. Wilkinson* and Mr. Hume also upholds the above theory, but the facts as brought out in the record absolutely refute those general statements.

GENERAL CONSIDERATIONS.

Capt. Gifford, the manager of The Ohio Valley Company, said that the stockholders of that company invested \$255,000.00 in money in that plant. It charged lower rates than the complainant and yet with that capital it built 10 exchanges, expending over \$500,000.00 thereon, and toll lines at a cost of over \$125,000.00. It paid dividends on \$550,000.00 of capital stock at the rate of 7 per cent per annum and had a surplus left over. (See Record, p. 959).

Mr. Wilkinson says the complainant got from the Ohio Valley Company a profitable dividend paying business. (Record, p. 754)

Mr. Caldwell said that the earnings were practically nothing on small exchanges (Record, p. 531). He said that the company only operated in four or five cities of any size (Record, p. 531). He conceded that the company earned as much as 11 per cent profit on its exchanges at Evansville, Nashville and the other large cities not including Louisville and New Orleans, the two cities where an attempt has been made to regulate rates. (Record, p. 532).

Mr. Smith said he made a report to the Board of Trade of New Orleans showing that the company was only earning 99-100 of 1 per cent in New Orleans. (Record, p. 428). He shows that in 1900 the company paid 11 per cent dividend. (Record, p. 440.)

Mr. Webb gave deposition in 1902 in the case of Weller vs. Cumberland Telephone & Telegraph Company in the Jefferson Circuit Court, in which he filed a statement showing the earnings and operations of the company for the years 1900 and 1901. I took Mr. Webb's deposition in this case and had him produce exhibits filed by him in that case. (Record, p. 1580). I also had him refer to certain parts of his deposition in that case in which he stated that appellee earned about 7 per cent here during the years 1900 and 1901. When those statements are examined it will be found that the company earned a great deal more than 7 per cent. For instance, the rentals for the year 1900 amounted to \$244,000.00. The expenses for 1900 amounted to \$173,000.00. These expenses, as shown by the exhibits, included \$42,000.00 representing depreciation, which \$42,000 was not expended during the year, but was supposed to be set aside to represent future depreciation. (See this Brief, pp. 177 to 179.)

This statement for 1900 also included \$17,000.00 instrument rental, which is certainly \$13,000.00 in excess of what should have been expended. If only \$42,000.00 (the unexpended depreciation), be deducted from expenses it will leave a net revenue of \$112,000.00. The exhibit shows the cost as of December 31, 1900, to be \$1,000,000.00, whereas the record in this case shows that the cost on December 31, 1900, did not in reality exceed \$600,000.00 (about \$450,000.00 representing the purchase of the Ohio Valley Company and \$150,000.00 having been expended on construction during the year 1900). \$112,000.00 net profit is, therefore, about 19 per cent on \$600,000.00 capitalization.

For the year 1901 the rental amounted to \$287,000.00 and the expenses amounted to \$212,000.00. In these expenses is included \$39,000.00 representing the amount set aside for depreciation, but not expended during the year, and \$21,000.00 rental of instruments, which is \$17,000.00 in excess of what should have been allowed. Deducting only \$39,000.00 (the unexpended depreciation), from the \$212,000.00 expenses, leaves a balance of \$173,000.00, which deducted from the rental, leaves a net revenue of \$114,000.00. This statement for 1901 shows the capital was then \$1,145,000.00, but in reality it was only about \$745,000.00 (\$145,000.00 having been added during the year 1901, according to Mr. Webb's exhibit). The net revenue, therefore, for the year 1901 according to this statement of Mr. Webb was over 15 per cent on the amount of the capital invested.

In view of the record in this case, it is idle for appellee's officials to claim that it has not made money in Louisville. Every fact brought out belies such contention.

There is absolutely nothing to support it except the general statement, that "unfortunately in Louisville we have not made any money."

The annual report of complainant for the year 1908 shows that the company paid \$1,630,000.00 dividends and interest.

The surplus increased \$518,000.00.

The amount invested in the plant increased \$500,000.00 and there were no sales of stock that year.

The reserve increased \$180,000.00.

The undivided profits increased \$50,000.00.

All of the above increases were out of the earnings, and show that the company for the year 1908 paid 8 per cent dividend and set aside out of its earnings an additional sum of \$1,250,000.00. (Record; p. 591.)

By referring again to the opinion of this Court in the case of the Railroad Commission vs. Cumberland Telephone & Telegraph Company, 212 U. S., 420, the following language will be found:

"The president of the company testified that, unless things changed, and it was permitted to charge the rates which had been charged prior to the adoption of these rates which are now in question, it would be unable to continue to pay 7 per cent, and that the company would necessarily retrograde; and that, while the company had paid 7 per cent to its stockholders for the past few years, it could not continue so to do if the rates in question were adopted, that it did not, in fact, receive anything like 7 per cent upon its investment in Louisiana."

If the case at bar were to be decided on the deposition of Mr. Caldwell the same language could be used.

If the general statements of Mr. Caldwell's deposition are to be accepted then the same situation exists in Louisville.

The litigation in that case involved the earnings for the year 1906. In the year 1908 the rates were increased from 7 to 8 per cent (Record, p. 621) and in 1909 a 11 per cent dividend was paid. (Record, p. 440.)

These facts speaks for themselves.

Coming now to another subject:

Mr. Smith has most remarkable views concerning the rates which complainant should be allowed to fix in Louisville. In view of the fact that he stated and insisted that the company was losing money in Louisville, I took occasion to ask him some questions in order to bring out his views about how much the company should be permitted to charge for telephone service in Louisville. In this connection, Mr. Smith gave this remarkable testimony (see Record, pp. 468 to 470) :

"Q. How much do you say should be set aside for depreciation to take care of the necessary decay in the plant?

"A. Our company has always adhered to the 7 1-2 per cent basis believing that that sum is required in reconstruction and depreciation.

"Q. And on what figures should that 7 1-2 per cent be calculated?

"A. It should be calculated on the book cost of the plant.

"Q. Then 7 1-2 per cent on the \$1,704,000 would amount to how much?

"A. About \$127,000.

"Q. And what are the earnings for 1908 according to your figures?

"A. The net earnings, before this depreciation is deducted is \$100,719.03 on the plant excluding real estate.

"Q. How much was spent for that year in the way of depreciation?

"A. My statement shows \$19,535.72.

"Q. And that deducted from the amount which should have been set aside for that year amounted to how much?

"A. It leaves a balance unexpended of \$108,269.97.

"Q. And the difference between the net earnings then and the amount which would have been set aside in addition to what was used for depreciation was how much?

"A. A deficit of \$7,550.94.

"Q. And how much in your opinion should the company be allowed to earn as a return for the amount invested in its plant?

"A. About 10 per cent.

"Q. And ten per cent of that is how much?

"A. \$199,000.

"Q. And adding the \$7,000 figured which was the deficit in depreciation would make how much?

"A. Yes, sir; \$197,000.

"Q. How much was the income from the real estate?

"A. \$11,707.52.

"Q. And that deducted from the former figure leaves how much?

"A. About \$186,000.00.

"Q. And that is the amount that you say the company should have earned in addition to what it already earns in Louisville?

"A. Yes, sir.

"Q. Now what were the total gross earnings for the year 1908 from revenue and miscellaneous items according to exchange earnings?

"A. \$324,026.75 as shown by me.

"Q. What percentage of increase over that amount would the \$186,000.00 make?

"A. About 57 per cent.

"Q. Then you say that your rates in Louisville should have been increased 57 per cent in order to earn what you were entitled to earn for the year 1908?

"A. I should say that the gross revenue should be greater.

"Q. They would have to be increased 57 per cent in order to earn that amount of money, would they not?

"A. It would not be my problem to consider just how to increase that revenue."

In view of Appellee's contention that the telephone business is exceedingly hazardous, I call attention to an exhibit filed with the deposition of Mr. Caldwell, President of the Company, which exhibit is a statement issued by one of appellee's sales agents. (Record page 621) Mr. Caldwell admitted that the statements contained in the exhibit were true. (Record page 547). Here is a part of the statement:

"The fact that the earnings of the Company justified an increase in dividends from 7 per cent to 8 per cent per annum, beginning October 1, 1908, reflects great credit on the managers and officers of the Company, especially when it is remembered that just at this particular time most all other corporations were still suffering from the effects of the panic of 1907, quite a number having reduced their dividends, while many discontinued paying altogether. It was thoroughly demonstrated all through the panic year of 1907 that telephone properties (Bell Licensed) when properly managed suffer less during times of depression than most any other class of business. During the months of October and November, 1907, right at the worst time of the panic, the toll and rental re-

ceipts of the Cumberland Telephone Company were \$1,019,000.00 as compared with \$918,000.00 for the same period of time the previous year, showing a gain of \$101,000.00, notwithstanding the hard times. The fact that the telephone business is done practically on a cash basis is another safeguard towards protecting its earnings during times of depression."

WHAT RETURN IS APPELLEE ENTITLED TO EARN ON THE VALUE OF ITS PLANT?

The Master found from the evidence that the appellee was entitled to a return of 6 per cent on the value of its plant. (Record, p. 94).

The Court found from the record that the appellee should be allowed to earn 7 per cent. (Record, p. 1640).

The net earnings of appellee for the year 1908 had the rate ordinance been in force, would have been so greatly in excess of 7 per cent that there is no occasion for the Court to discuss or determine this question.

Mr. Hilliard, a broker of the City of Louisville, gave the only deposition in the record bearing on this subject. (Record, p. 1009).

It is impossible to read Mr. Hilliard's deposition without being impressed with his intelligence and knowledge of the subject. He showed that there is an active demand in the City of Louisville for gas stock, electric light stock, heating stock and railway stock at prices which do not yield over 5 per cent on the investment.

The record discloses that there are no great hazards connected with the telephone business.

Six per cent is held by this Court to be a reasonable return in the late case of Wilcox vs. Consolidated Gas

Company, 212 U. S. 19, and also in the case of Stanislaus County vs. San Joaquin Canal Co., 192 U. S. 201.

In the case of City of Knoxville vs. Knoxville Water Co., 212 U. S. 29, the language used by this Court would imply that 4 per cent was a reasonable return.

In the case of Cedar Rapids Co. vs. Cedar Rapids, 118 Iowa, 234, the Court held that a 5 per cent return on a water company's plant was reasonable.

This is not a case such as the Knoxville Water case or the Consolidated Gas case wherein there was a doubt concerning the practical operation of the rates. It is therefore not a case in which the lower Court should be directed to require appellee to give the rates a fair trial, retaining the case on the docket until such fair trial was given.

All the witnesses, including the President of the company, concede that putting the rate ordinance into effect will result in increasing the number of subscribers. (Record, pp. 835-836). With its present subscribers only, the record shows that appellee will earn more than 11 per cent on the value of its plant.

CONCLUSION.

In conclusion, I call attention to the fact that practically every contention made by the City is based on undisputed facts, all but one being founded on evidence produced by the appellee's own officials.

Witness as follows:

A. That it is impossible to determine how much appellee's plant cost is conclusively shown by the auditor.

B. That the earnings under the rate ordinance for the year 1908 would have been \$9,000.00 in excess of what they were under the old discriminatory rates is shown by the auditor, as supplemented by Mr. Warren, the City's accountant. The depositions of the auditor (re-called) and of Mr. Wilkinson, appellee's accountant, (rebuttal) were taken after Mr. Warren's deposition was concluded, and no attempt was made to refute any statement made by him in this respect.

C. That the cost of the toll equipment and toll construction has been charged to the Louisville exchange is shown by the deposition of the auditor.

D. That all expenses of conducting the toll department including maintaining the toll property have been paid by the Louisville exchange is shown by the deposition of the auditor. That those expenses were in excess of \$30,000.00 per year for the years 1905, 1906, 1907 and 1908 is shown by the deposition of Mr. Warren, the City's accountant, and his statements in this respect are not refuted.

E. That for a period of twenty years 7 per cent on the value of the plant has been sufficient to maintain and reconstruct the plant, is shown by the auditor and Mr. Wilkinson.

F. That appellee charges as a part of the expenses of the exchange 8 per cent on the book value of the real estate and requires the exchange to pay in addition thereto all the taxes and insurance on the buildings, is shown by the auditor.

G. That the appellee pays to the American Telephone Company \$13,700.00 a year for the use of instruments, which is \$9,000.00 in excess of the reasonable rental, is shown by the auditor and by Mr. Polk, the last named witness placing a value on the instruments which is nowhere questioned.

H. That appellee has included in its expenses an item representing what it would have received for the use of free telephones had it charged the regular rates therefor, is shown by the deposition of Mr. Warren, and his statements in this respect are not refuted anywhere in the record.

The only contention made by the City which is not based on statements of appellee's officials or on undisputed evidence, concerns the value of the plant.

In view of the facts as shown in the foregoing pages it is respectfully submitted that the decree of the lower Court should be reversed.

First, Because appellee is a trespasser and wrong-doer in the streets of the City of Louisville and, therefore, not entitled to have a Court of Equity give it protection in order that it may prosper while continuing to violate the law.

Second, Because the appellee's officials have failed to frankly and fully disclose all facts pertinent to the issues between the parties.

Third, Because the plant on which appellee seeks to earn a return, was constructed partly out of the earnings of that plant, the extent of which earnings not being disclosed by the appellee, the judgment in its favor cannot be affirmed.

Fourth, And finally, because the rates as established by the ordinance in question are clearly reasonable.

Appellant, therefore, respectfully urges a reversal of the decree entered in the Circuit Court, with instructions to the lower Court to dismiss the bill.

Respectfully submitted,

CLAYTON B. BLAKEY,

City Attorney,

For Appellant.

HUSTON QUIN,

JOSEPH S. LAWTON,

Of Counsel.

February 20, 1912.

Office of the Clerk, U. S.
FILED.

MAR 2 1912

JAMES H. MCKENNEY,

CLERK.

No. 761

Supreme Court of the United States

OCTOBER TERM, 1911

CITY OF LOUISVILLE, Appellant,

vs.

CUMBERLAND TELEPHONE & TELE-
GRAPH COMPANY, Appellee.

SUPPLEMENT TO THE BRIEF AND ARGUMENT
ON BEHALF OF APPELLEE.

ALEXANDER POPE HUMPHREY,
ALEXANDER POPE HUMPHREY, JR.,
WILLIAM L. GRANBERY,
Solicitors for Appellee.



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CITY OF LOUISVILLE. Appellant,

vs.

CUMBERLAND TELEPHONE & TELEGRAPH
COMPANY. Appellee.

SUPPLEMENT TO THE BRIEF AND ARGUMENT ON BEHALF OF APPELLEE.

May it Please Your Honors:

This cause was referred to a Special Master to take proof and report to the Court on various issues raised in the pleadings. After the Master's report was filed, Appellee filed elaborate exceptions thereto, all of which are contained in the printed record; but it has been thought that it would aid the investigation of the cause by your Honors if the Master's report and exceptions should be printed in convenient form.

Therefore, the Master's report and Appellee's exceptions thereto have been reprinted, and citations to the evidence have been made to conform to the paging of the printed record, and the exceptions of Appellee to each particular heading of the Master's report are inserted for convenience immediately after the Master's report under that heading.

An examination of the Master's report and the exceptions filed by Appellee, is, we respectfully submit, a sufficient analysis of this

voluminous record to enable your Honors to understand the issues and the facts involved without the labor of critically examining the two large volumes of the printed record.

This rearrangement of the Master's report and Appellee's exceptions is filed as a supplement to, and as a part of, our brief and argument in this Court.

Respectfully submitted,

ALEXANDER POPE HUMPHREY,

ALEXANDER POPE HUMPHREY, JR.,

WILLIAM L. GRANBERY,

Solicitors for Appellee.

February, 1912.

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The Material Evidence in Chronological Order

Deposition—	<i>Date taken</i>
H. Blair Smith, Direct	April, 1909
H. Blair Smith, Cross	Aug.-Sept., 1909
James E. Caldwell	Sept., 1909
Wm. H. Crumb	Oct., 1909
Capt. H. N. Gifford	Oct., 1909
Hardy Burton	Oct., 1909
John H. Brand	Oct., 1909
J. E. Settle	Oct., 1909
Isaac Hilliard	Oct., 1909
H. B. Warren	Oct., 1909
S. D. Levings	Nov., 1909
T. D. Webb	Dec., 1909
W. H. Casler	Jan., 1910
Chas. E. Archer	Jan., 1910
Chas. Merriwether	Jan., 1910
S. M. Wilhite	Jan., 1910
Chas. Merriwether, Re.	Jan., 1910
Jas. F. Grinstead	Jan., 1910
W. G. Polk	Jan., 1910
J. E. Jagoe	March, 1910
Leland Hume	March, 1910
H. Blair Smith (Second)	March, 1910
E. M. Fisher	March, 1910
George Wilkinson	March, 1910
W. C. Polk (Second)	April, 1910
James E. Caldwell (Second)	April, 1910
O. D. Green	April, 1910

Reports—

Accountant's Joint Report	July, 1909
Geo. Wilkinson	July, 1909
Mutual Audit Company	July, 1909
George Wilkinson, Reply	Aug., 1909

UNITED STATES CIRCUIT COURT

SIXTH CIRCUIT

WESTERN DISTRICT OF KENTUCKY

CUMBERLAND TELEPHONE & TELEGRAPH
COMPANY, Complainant,

vs.

CITY OF LOUISVILLE, Defendant.

REPORT AND FINDINGS OF THE SPECIAL MASTER.

As Special Master herein, I respectfully present this, my Report and Findings, as directed by the orders of this Honorable Court, made and entered on the second day of April, 1909, in the above styled case.

The evidence taken and produced before me on behalf of Complainant is contained in the depositions of the following witnesses: H. Blair Smith, James E. Caldwell, O. D. Green, George Wilkinson, J. E. Jagoe, Leland Hume, and E. M. Fisher. The Joint Report of Wilkinson and Farnham.

On behalf of Defendant, the evidence consisted of the depositions of the following: Wm. H. Crumb, H. N. Gifford, Hardy Burton, John H. Brand, J. E. Settle, Isaac Hilliard, H. B. Warren, S. D. Levings, W. C. Polk, report of D. C. Jackson, Norton E. Westlake, Gainsey R. Johnston, James T. Daniels, J. W. Hart, Reuben G. Trail, Howard P. Yeager, Alice C. Everett, T. D. Webb, George M. Welsh, and Robert Frewin.

The depositions of William Kavanaugh, H. W. Ritterhoff, and Charles M. Peale were not considered by me. Exceptions were filed to these depositions by Complainant upon the ground that the witnesses refused to answer questions on cross-examination. I sustained the exceptions, and Defendant entered its exceptions to my ruling.

I considered the reports of the accountants, George Wilkinson and E. W. Farnham, rather as briefs on their respective sides, than as evidence.

I am directed to find:

I.

"The cost to Complainant of its plant and property in the City of Louisville, Kentucky, and in doing this, he will state generally the basis of his estimate thereof."

In 1899, the Ohio Valley Telegraph & Telephone Company owned and operated a telephone plant in the City of Louisville, New Albany and Jeffersonville, Indiana, and in seven small towns in Kentucky, and also a series of toll lines, all connected with the Louisville Exchange. Its capital stock was 5,494 shares of \$100.00 each, amounting at par to \$549,400.00.

Complainant acquired all of these exchanges and all the property of the Ohio Valley Company in the following manner:

In the month of June, 1899, it purchased 702 shares of the capital stock of the Ohio Valley Company, and paid therefor \$140.00 per share	\$ 98,280.00
Subsequently it purchased 2,855 shares at \$141.00 per share	402,555.00

There were left, of the total issue of the capital stock of the Ohio Valley Company, 1,937 shares, and these were acquired by Complainant by exchanging an equal number of its own shares of stock for the 1,937 shares of the Ohio Valley Company.

It is urged that these purchases of the Ohio Valley Company's stock fixed the market value thereof in June, 1899, at \$141.00 per share. Based upon that assumption Complainant insists that the value of its 1,937 shares which it exchanged at par for the Ohio Valley Company's shares, should have the added value of \$41.00 per share, to-wit _____ \$

79,979.91

That is to say, Complainant contends that it has actually paid out for 1,937 shares of the Ohio Valley Company's stock in exchange, the equivalent of \$193,700.00, and in addition thereto, the approximate premium thereon, amounting to _____

79,979.91

I am unable to accept this specious reasoning. The evidence shows that prior to 1900, and during each of the years succeeding, up to 1908 inclusive, the Complainant Company sold its shares of capital stock in various large amounts, but the price at which such stock was sold was invariably at par.

I find, therefore, that the 1,937 shares of capital stock of Complainant Company were exchanged for an equal number of shares of the Ohio Valley Company, and that the amount expressed in dollars thus expended was _____

193,700.00

It thus appears that the total paid out by Complainant Company for all of the capital stock of the Ohio Valley Company was _____

694,535.00

The Ohio Valley Company, at the time of these purchases, owned and operated, besides the Louisville Exchange, and in connection therewith, nine smaller exchanges and a number of toll lines leading out of Louisville, all connected with the Louisville Exchange. The construction cost of these toll lines was ascertained by the Joint Report of Wilkinson & Farnham to have been _____

If we deduct this amount from the total cost of the entire capital stock of the Ohio Valley Company, we find that the actual cost of all the exchanges of the Ohio Valley Telephone Company was _____

125,406.80

569,128.20

In arriving at the cost of the Louisville Exchange, it appears that an arbitrary basis of 80.4 per cent of the total cost of all the exchanges was fixed by Complainant.

Without determining the absolute correctness of this calculation, I accept it, and I find that the cost of the Louisville plant on this basis, as of the first of January, 1900, was \$ 457,579.07

The cost of the real estate in Louisville, which was acquired from the Ohio Valley Company, and which was necessary for the proper conduct of its business, as of date January 1, 1900, was 108,034.50

Total \$ 565,613.57

It may elucidate and strengthen the correctness of the above findings, by calling attention to the fact that the books of the Ohio Valley Company show, as of December 31, 1899, that the total construction of all its exchanges cost that company..... \$ 638,196.74
Deducting the cost of toll lines 125,406.80

We have \$ 512,789.94

This being the book cost of the entire plant as of December 31, 1899, as shown by the books of the Ohio Valley Company.

These figures do not include the real estate, to-wit 108,034.50

Total \$ 620,824.44

If we were to apply the same process to the above figures as to those on the preceding page, we would find the total book cost of the plant or exchange in Louisville \$ 412,283.11
This last amount being 80.4 per cent of \$512,789.94.
Add cost of real estate 108,034.44

We have a total cost on this basis of \$ 520,317.55

It is insisted by Complainant that to the book cost of the Ohio Valley Company's plant, as it appears on Complainant's books, to-wit	\$ 638,196.74
There should be added	135,505.70

The basis of this claim is that during the period of 1890 to 1899 inclusive, the Ohio Valley Company had, from its earnings, credited annually to its Construction Account, in the aggregate	135,505.70
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It is urged that this aggregate amount was charged off from Construction ostensibly to cover depreciation of plant during the period named, but that depreciation had been completely guarded against annually by an expenditure of an average amount of nearly ten per cent of the book cost of the plant during the years from 1890 to 1899 inclusive, and that therefore it was unnecessary and improvident to credit the Construction Account with this sum of \$135,505.70.

It is impossible at this time—at least from this record—to ascertain the reasons or motives of the Ohio Valley Company's management in making these entries of credits. It is not probable that the entries would have been made, unless the reasons therefor were of a compelling nature. No officer of the Ohio Valley Company has testified about the matter, except Capt. Gifford, Treasurer of the Company, and he says the credits were made to Construction to cover depreciation. If that be true, and there is no contradiction in the record, then I find that the credit must remain and should not be disturbed.

I find that the cost of the Ohio Valley's plant in Louisville, not including toll lines nor real estate, was	457,579.07
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The Joint Report of the two experts shows that, according to the books of the Complainant Company, the additions to the Louisville plant or exchange from 1900 to 1908, both inclusive, amounted to	1,023,545.34
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Which would make a total of	\$1,481,124.41
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I have been embarrassed by the conflict in the evidence as to the correctness or propriety of charging items of cost to what the accountants call the Construction Account.

The principal witness of Complainant as to these questions was Mr. Blair Smith, the company's auditor. The witness did not, and of necessity could not, testify from personal knowledge as to a great many items of such cost as to which he was interrogated. His answers to very many of such inquiries were that bills or vouchers, showing certain cost of materials and labor, were sent to him at the Nashville office, accompanied by a memorandum or notation made by a clerk in the Louisville office, and that acting upon the verity of such notations, he entered the several amounts as a proper charge to the Construction Account.

It is not clear to my mind that this is the best evidence of the correctness of such charges. I have not felt justified in rejecting such evidence, but I have carefully considered all the evidence produced which tended to discredit any and all such entries.

The great mass of the evidence, and the hundreds of detailed matters touching the correctness of charges that constitute the Construction Account, forbid any attempt to treat them singly. In fairness to both parties to this litigation, I am forced to treat these matters in a general way, and to arrive at what I consider a fair and equitable estimate of what I believe to be erroneous charges to this account.

I have decided on this plan of estimating the amount of erroneous charges to the Construction Account for two reasons:

First: The evidence on the point fails in many instances to disclose the amount of what are alleged to be erroneous charges, but merely discloses what is said to be an incorrect theory.

Second: In the case of *City of Knoxville vs. Knoxville Water Company*, 212 U. S., 16, we find the following:

"The jurisdiction which is invoked here ought, as has been said, to be exercised only in the clearest cases. If a company

of this kind chooses to decline to observe an ordinance of this nature and prefers rather to go into court with the claim that the ordinance is unconstitutional, it must be prepared to show to the satisfaction of the court that the ordinance would necessarily be so confiscatory in its effect as to violate the Constitution of the United States."

With the foregoing reasons as my guides, I have examined with great care certain phases of the evidence in respect of the cost of the Louisville Exchange.

Many vouchers were produced at the hearing, covering the wages of men employed in and near Louisville in connection with the aerial work, including toll lines. These vouchers show that certain wages and salaries had been expended on the aerial lines, and also on underground lines connected with the Louisville Exchange. A small proportion of these outlays was charged to Maintenance or Reconstruction, while the bulk of the outlays is charged to Construction.

The evidence offered by Complainant is that the wages and salaries were used in construction, because they are charged to that account. No witness was introduced who pretended to have personal knowledge as to any of these items.

It may be proper to mention in this connection that Complainant generally kept three accounts to take care of the above referred to three departments, to-wit: Maintenance, Reconstruction and Construction.

The evidence tends to show that in nearly every instance, the wages of the employes shown in the vouchers we are considering, were charged almost wholly to Construction, and no evidence of the correctness of such charges was offered, except that the vouchers bore a notation to that effect.

It is inconceivable that so little of these wages was properly chargeable to Maintenance or Reconstruction from 1900 to 1908. The aggregate amount of these vouchers was not shown in evidence.

The evidence shows that Complainant kept a Supply Department,

from which it issued, on requisition, all kinds of general supplies, other than switchboard sections and other large parts. Materials of all kinds are purchased by Complainant at wholesale (Trans., p. 326), and stored in a warehouse for use of the Louisville Exchange and adjacent exchanges. The Complainant uniformly charged on all supplies furnished to the Louisville Exchange a premium of ten per cent over and above original cost.

One witness, Mr. Warren, testifies that from 1900 to 1908, both inclusive, the supplies thus furnished, according to the books of Complainant, amounted to \$518,000.00. I do not find this statement of Mr. Warren to be altogether accurate, but it is fair to assume that it is an approximation.

If, therefore, this ten per cent added charge on supplies be improper and unfair to the exchange, the amount of such an overcharge would be in the neighborhood of \$50,000.00.

Vouchers from the Supply Department were called for but not produced by the company's auditor, the reason being given that he had no control over the Supply Department. (Trans., p. 357.)

The evidence shows that the vouchers for supplies were sent into the Nashville office from the Louisville office, accompanied by a notation as to how the amounts were to be charged—whether to Maintenance, Reconstruction or Construction. But the evidence is most unsatisfactory as to whether the supplies were accurately distributed in the books of account. Vouchers from the Supply Department showed totals only, and the amounts were entered on the books in accordance with the notations of the Supply Department clerks.

Mr. Smith (Trans., p. 326-7), says as to the added charge of ten per cent for supplies, that it was to cover freight, drayage, rentals, etc.

I find that this charge on all supplies furnished is at least a burden on the business in Louisville, and should not be allowed. The company in the first instance must have paid freight and drayage on all supplies furnished. The company doubtless received the usual trade discount for cash. As to how the freight and drayage were charged,

or the cash discount credited, the record is silent. I do not doubt that proper and correct entries were made on the company's books as to the rent of the supplies warehouse. This is doubtless charged to expense of supplies.

The amount of this ten per cent added charge, like the items of wages, is a matter of conjecture, but it is obviously a substantial amount, extending from 1900 to 1908, both inclusive. At the argument, counsel for Complainant admitted that the items of drayage, freight, rental, etc., are charged primarily to Supply Expense, but that ultimately they are charged to the operation of the exchange.

I find, therefore, that this added charge of ten per cent on the cost of supplies furnished to the Louisville Exchange, must be disallowed. The aggregate amount of such added charge is not, under the evidence, susceptible of definite ascertainment, and must necessarily be estimated.

Again, it appears from the evidence that for several years all the apparatus for installing a subscriber's station, including labor, were charged to construction, and that in addition thereto an arbitrary charge of \$10.00 for each instrument installed was made to construction. (Trans., p. 351-2.)

Finally, say in 1907—the evidence is very indefinite—both plans were abandoned. The explanation given by Mr. Smith, the Auditor, and by Mr. Caldwell, President of the Complainant, as to the correctness of this ten dollar charge on each instrument gained, is unsatisfactory. They say that if the company installed one thousand instruments in a given month, and took out two hundred instruments, the company has obviously gained eight hundred instruments. On the number of instruments thus gained, the company entered a charge to Construction of \$10.00 for each instrument, making a total of \$8,000.00. I find that this method of charges ought not to be sanctioned.

There is a sharply defined difference in the evidence as to the cost of the conduit system in Louisville, somewhat due to the varying opinions as to the sizes of the wires used in the cables, and conse-

quently the amount of copper contained, as well as the mode of construction.

The witnesses who testified as to the conduit system seemed to be equally expert, but they differ so widely, and they appear to be so convinced of the correctness of their opinions, that I am unable to reconcile them.

There are many individual items charged to Construction which are challenged by the Defendant. The largest one is an item of \$26,000.00 charged to Construction on account of five sections of switchboard, which Defendant says were shipped away from Louisville after having been installed in the main exchange. Mr. Smith says he has an impression that some parts of the main switchboard were removed from Louisville. At the argument, complainant contended that these five sections were removed to the West Exchange in Louisville. To rebut this, it is contended by Defendant that vouchers were exhibited by the company's Auditor, which show that the cost of the five sections of switchboard in the West Exchange was only \$17,000, and that amount was paid by Complainant in addition to the disputed item of \$26,000.00, and that both amounts appear as parts of Construction Account.

I have gone over this evidence carefully, and while the facts brought out in evidence are not satisfying, yet, as the expert accountants who examined the books make no mention of this alleged discrepancy, I am disposed not to disturb the account as to the two items last above mentioned.

Again, the evidence shows that there are many toll lines leading out of Louisville. These lines are devoted to what are commonly called "long distance messages." No separate account is kept showing the cost of operation of the toll lines. (Trans., p. 300.) The maintenance and reconstruction of the toll lines, and in some, if not in every instance, original cost of additions to the Toll Department, were charged to Construction, Louisville Exchange. (Trans., pp. 327-328.)

In January, 1900, and in December, 1901, toll switchboards and

keyboard equipment, etc., were purchased for the Toll Department, and the cost was all charged to Construction Account of the Exchange. (Trans., pp. 329, 331.)

Mr. Smith, Auditor, and Mr. Caldwell, President of Complainant, state that because of the toll lines and their easy accessibility to the Louisville subscribers, the value of the service to the subscribers is greatly enhanced.

I have considered the practice of the Complainant to charge to Construction Account additions to the toll equipment in the several exchanges in Louisville, and further, that the maintenance and reconstruction of toll lines were charged to the Louisville Exchange. The amounts of the erroneous charges to Construction Account from which we must find the cost of the Louisville Plant or Exchange, is necessarily problematical, and under the evidence in this record, it is not susceptible of definite ascertainment. I am compelled, therefore, to make an estimate of the proper amount to be deducted from Construction Account, having due regard to the interests of both parties to this controversy, and I am of the opinion that a fair and most conservative estimate of what has been charged to Construction Account under a mistaken theory is, at the very least, \$100,000.00, which must be deducted from \$1,481,124.41.

I find, therefore, that the cost of the Louisville Exchange, including toll lines, but excluding real estate, is \$1,506,531.21

EXCEPTIONS OF APPELLEE.

The Master reported that the Complainant acquired the properties of the Ohio Valley Telephone Company in 1899, and that this acquisition was made in the following manner:

Complainant purchased in June, 1899, 702 shares of the capital stock of the Ohio Valley Company at \$140.00 per share, and 2,855 shares at \$141.00 per share, making a total paid for 3,557 shares of \$500,855.00. This is correct, and not excepted to.

There were left outstanding 1,937 shares of the Ohio Valley Telephone Company's stock which was acquired by Complainant issuing

a like number of its own shares to the holders of the shares of the Ohio Valley Company. The Master reports that this additional 1,937 shares only cost Complainant the par value of its stock, to-wit: \$193,700.00, whereas Complainant insists that this stock cost it \$79,417.00 additional.

"A"

Complainant excepts to the disallowance of this item of \$79,417.00, premium on 1,937 shares of the Ohio Valley Telephone Company's stock, for the following reasons:

Complainant's stock was selling in the open market at about \$141.00 per share (a share in Complainant company and in the Ohio Valley Company each being \$100.00 par value). Trans., p. 500.

It is insisted by Complainant that since its shares were selling for a premium of \$41.00 in the open market, and it purchased a large number of shares of the Ohio Valley Company at a premium of \$41.00 per share, that in determining the cost to Complainant of the shares acquired by exchanging a like number of its own shares, this premium of \$41.00 per share must be allowed, since it is apparent that if Complainant had sold 1,937 shares of its own stock it would have received \$79,417.00 *more* than its par value, and if it had purchased for cash the 1,937 shares of the Ohio Valley Company's stock it would have paid therefor \$79,417.00 *more* than its par value.

Again, if Complainant acquired 1,937 shares of Ohio Valley Company's stock at par, it received property which was worth \$79,417.00 *more* in the open markets of the country than was paid for it, and it gave for these 1,937 shares property that was worth \$79,417.00 *more* than its par value.

The Master refers to the issuance by Complainant of its stock from a period back of 1900 to 1908 at par. In other words, his statement is that all the stock sold by Complainant from a period back of 1900 to 1908 was upon a par basis. In this matter the Master is only partially correct.

It is true that the *new issues* of stock during all that period have

been issued to existing stockholders pro rata at par (Trans., p. 384-5), but this was not in any sense determinative or indicative of the real value, or market value, of Complainant's stock. Under well settled principles of law, corporations, in all increases of capital stock, are required to issue such increases to its existing stockholders pro rata. This is a right existing shareholders have to acquire their proportion of each new increase of stock. It is a right attaching to the ownership of stock, and such stockholders have the right to take and pay for their pro rata shares of new issues of stock.

It thus appears that the Master, conceding that the Ohio Valley Company's stock was worth in the open markets of the country a premium of \$41.00 per share, holds that because of the *manner* in which Complainant acquired 1,937 shares, its value decreased \$41.00 per share, or a total of \$79,417.00, when any other purchaser would have paid therefor a premium of \$79,417.00; and Complainant itself could immediately, after acquiring these shares, have sold them for a premium of \$79,417.00.

So that we insist that the Master was in error in not allowing this item of \$79,417.00 as a part of the purchase price of the property of the Ohio Valley Telephone Company.

"B"

The Master assumes, and treats, the entire properties of the Ohio Valley Telephone Company as worth on January 1, 1900, the exact amount Complainant paid for its shares of stock in June preceding, less the premium of \$79,417.00 on the 1,937 shares as above stated. Complainant excepts to this finding of the Master for the following reasons:

It is well settled that the market value of the share capital of a corporation does not necessarily represent the value of the corporate assets. The stock simply represents the equity of the shareholders in the corporate assets. Creditors have a first claim upon the assets, and it is only after paying creditors that the shareholders are entitled to any part of such assets. Therefore, where the shares have a market value, the value of the corporate assets is to be measured by the market value of the shares, *plus* the indebtedness of the company, and this

principle has been entirely overlooked by the Master in ascertaining the cost to Complainant of the property of the Ohio Valley Telephone Company.

As found by the Master, the shares of stock of the Ohio Valley Telephone Company were acquired by Complainant in June, 1899, and as soon as this stock was acquired new officers of the Ohio Valley Company were elected, and the property operated as an independent corporation until January 1, 1900, when it was consolidated with the Cumberland Telephone & Telegraph Company—both being Kentucky corporations—and the consolidating company, under the name of the Cumberland Telephone & Telegraph Company, took over the assets of the two consolidating companies, and assumed all their liabilities.

From June, 1899, when the new management of the Ohio Valley Company took charge, until January 1, 1900, when the consolidation took place, all of the earnings of the Ohio Valley Company, and a large amount of borrowed money, was used in building up the properties of the Ohio Valley Telephone Company, so that on January 1, 1900, the situation was wholly different from that of June preceding, and the value of the assets of the Ohio Valley Company on January 1, 1900, was greater than in June preceding.

Eliminating every disputed item in the accounts, the following were the liabilities of the Ohio Valley Telephone Company in June, 1899, when the new management took charge, and those subsequently incurred prior to January 1, 1900:

Liabilities.

In June, 1899, the Ohio Valley Company had out-	
standing bonds.....	\$ 16,000.00
(Trans., p. 246.)	
Taxes accrued and unpaid.....	4,000.00
(Trans., p. 254.)	
Interest accrued and unpaid.....	7,770.00
(Trans., p. 254.)	
Switchboard royalty accrued and unpaid.....	2,404.59
(Trans., p. 254.)	

Bills payable, January 1, 1900	\$ 221,005.90
(Trans., p. 255.)	
Miscellaneous accounts payable	63,755.16
(Trans., p. 267.)	
Special account December 31, 1899	38,875.16
(Trans., p. 254.)	
Or a total liability of	\$ 353,810.00

As against these liabilities the Ohio Valley Telephone Company had acquired real estate and current assets, as follows:

Assets.

Real estate	\$ 115,765.46
(Trans., p. 274.)	
Accounts receivable	9,198.01
(Trans., p. 275.)	
Supplies on hand	37,299.59
(Trans., p. 275.)	
L. K. Webb, Auditor	30,215.18
(Trans., p. 275.)	
Cash on hand	288.81
(Trans., p. 275.)	
Or a total of	\$ 192,767.05
Excess of liabilities	161,042.95

This excess of liabilities, of course, was money expended in developing the properties of the Ohio Valley Telephone Company, and was the added cost above the market value of its shares of stock.

If, therefore, we add the amount paid for the shares of stock, including the premium of \$41.00 on the 1,937 shares, we have a total cost of the property of the Ohio Valley Telephone Company, on January 1, 1900, of \$935,014.95, exclusive of real estate.

These assets and liabilities are not only given by the company's Auditor, Mr. H. Blair Smith, but are set forth in the report of the Mutual Audit Company, on behalf of the City of Louisville, in exhibit one.

This, it will be recalled, is the total cost of the plants, exchanges and toll lines, excluding real estate, of the Ohio Valley Telephone Company as of January 1, 1900, when this property was taken over by the Complainant. It only remains to determine how this cost should be separated so as to ascertain the cost of the exchange in the City of Louisville.

The Ohio Valley Company owned and operated nine exchanges, including the one in the City of Louisville, and also had toll lines connecting these exchanges.

The Master has ascertained (which we accept) that the toll lines cost Complainant.....\$ 125,406.80

This item deducted from the entire cost of the exchange and toll lines of the Ohio Valley Company, as of that date, leaves the cost of exchange properties 809,608.15

It is conceded by the Master that 80.4 per cent of the exchange properties of the Ohio Valley Telephone Company was in the Louisville Exchange, and there is no dispute anywhere in the record as to this fact. Therefore, in order to ascertain the cost to Complainant of the Ohio Valley exchange in the City of Louisville on January 1, 1900, excluding the real estate and toll lines, we have 80.4 per cent of \$809,608.15, or..... 650,924.95

The cost of real estate in Louisville as found by the Master (and everyone agrees that it is correct) is..... 108,034.50

Making a total cost of the Louisville Exchange and real estate of.....\$ 758,959.45

(a) *Complainant, on January 1, 1900, took over the Louisville Exchange, exclusive of real estate and toll lines, at a cost value of.....\$ 678,354.69*

Trans., p. 245.

Mr. Smith testifies that this was, in his opinion, the actual cost to the Complainant company of the Louisville Exchange, as of January 1, 1900.

Trans., p. 218.

Mr. Caldwell, the President of the company, also testifies that the purpose of the company was to take over the Louisville Exchange and put it on the books at exactly what it had cost, and was worth, and this was done.....\$ 678,354.69

Trans., p. 500.

(b) Wilkinson, Complainant's expert accountant, examined the books of the Ohio Valley Company, and states the cost to the Complainant of the Louisville Exchange, exclusive of real estate, on January 1, 1900, to be..\$ 678,354.69

Trans., pp. 754 to 759.

In other words, Mr. Wilkinson sustains the company's books, and testimony of Mr. Smith, the company's Auditor, and Mr. Caldwell, the company's President.

The Mutual Audit Company experts made no examination of the books of the Ohio Valley Company.

Trans., p. 1030.

(c) The Mutual Audit Company, the expert for the city, reaches the conclusion that the exchange cost the company, on January 1, 1900, exclusive of real estate and toll lines..... 487,900.86

Trans., p. 1340.

This conclusion can not be accepted, since it is manifestly erroneous and full of the most glaring errors:

They disallow the premium on the 1,937 shares of stock purchased by an exchange of a like number of Complainant's shares, \$79,417.00. They prorate a part of the premium paid for the remainder of the stock of the Ohio Valley Company on the real estate in Louisville, amounting to \$21,233.25, when it clearly appears that the main exchange building was purchased by the Ohio Valley Telephone Company on June 3, 1899, for \$100,000.00, and this purchase was a *separate* transaction, and *after* the sale of stock.

Trans., pp. 501 and 522.

When the sale and purchase of the Ohio Valley Company's stock took place, the only real estate owned by the company was \$15,765.46. Of this, \$8,034.50 was located in Louisville. The remainder, \$7,730.96, in New Albany. (Trans., p. 755.) The Master had found the total real estate in Louisville to have been on that date \$108,034.50. Thus verifying the statement that the only real estate owned by the Ohio Valley Company in Louisville, at the time the stock was sold, was \$8,034.50. Supplies on hand are allowed a bonus on the stock value of \$6,850.37. Of course supplies were not entitled to any part of the premium paid for stock, since they are staple articles that carry their own cost value. This makes manifest errors in the figures of the Mutual Audit Company of more than \$100,000.00.

Trans., p. 1338.

It therefore appears that the Master fixes the cost of the Louisville Exchange, exclusive of real estate and toll lines, as of January 1, 1900, at.....\$ 457,579.07
Supra p. 8.

This is less than *any* witness places the cost, and it can not be ascertained from the record how such a conclusion was arrived at.

- a. The President of the Complainant says that it cost, and was worth..... 678,354.69
- b. The Auditor of Complainant says it cost the sum of 678,354.69
- c. Wilkinson, the expert accountant, says it cost Complainant..... 678,354.69
- d. The Mutual Audit Company's report of cost is not to be accepted.

An analysis of the evidence shows, as above set out on pp. 16 to 20, that the exchange cost on January 1, 1900, was at least the sum of..... 650,924.95

Complainant, therefore, insists that the Master is in error in fixing the cost of the Louisville Exchange, exclu-

sive of real estate and toll lines, at only \$457,579.07, and insists that the cost is shown to be \$678,354.69, and certainly not less than the sum of.....\$ 650,924.95

"C"

Whatever may be found to have been the cost of the Louisville Exchange as of January 1, 1900, exclusive of real estate and toll lines, there is no dispute but that there was added as additional construction to December 31, 1908, the sum of \$1,023,545.34. From this amount the Master deducts \$100,000.00, and to this part of the report Complainant excepts.

There should have been no deduction by the Master, because there is no evidence showing that any amount was erroneously charged to construction.

Notwithstanding the many criticisms of the Master as to this added construction, his disallowance of \$100,000.00 is based upon the following, as far as can be ascertained from his report:

- 1st. The "wages of men employed in and near Louisville in connection with aerial work, *including toll lines.*"
- 2nd. The small amount of wages charged to maintenance or reconstruction.
- 3rd. The addition of 10% to invoice price of materials, to cover freight, drayage, rentals, etc. This the Master estimates to be *at least \$50,000.00.*
- 4th. The charge of \$10.00 per station on each station gained to cover the cost of labor and material in making such installation.
- 5th. The cost of toll line equipment, and maintenance and reconstruction of toll lines.

After discussing each of these five objections to the added construction since January 1, 1900, the Master deducts the sum of \$100,000.00 (*supra* p. 15).

An examination of the record will show that as to each of these five subjects the Master was in error in deducting anything from this added construction account.

Under this heading of the Court's instructions, the Master is only undertaking to report the cost of the exchange to December 31, 1908.

In doing this he confuses construction with maintenance and reconstruction. Whether maintenance and reconstruction of toll lines was charged to maintenance and reconstruction of exchange, or vice versa, is wholly immaterial under this heading, when the sole inquiry is the cost to Complainant of its exchange property in Louisville.

The first criticism of the Master, as above stated, relates to wages of men employed in connection with aerial work, including toll lines. On page 11 of his report, he states:

"Many vouchers were produced at the hearing, covering the wages of men employed in and near Louisville in connection with the aerial work, including toll lines. These vouchers show that certain wages and salaries had been expended on the aerial lines, and also on the underground lines connected with the Louisville Exchange. A small proportion of these outlays was charged to maintenance or reconstruction, while the bulk of the outlays is charged to construction."

And on page 11 of his report, he says:

"The evidence tends to show that in nearly every instance the wages of employes shown in the vouchers we are considering were charged almost wholly to construction, and no evidence of the correctness of such charges was offered except that the vouchers bore a notation to that effect.

"It is inconceivable that so little of these wages was properly chargeable to maintenance or reconstruction from 1900 to 1908. The aggregate amount of these vouchers was not shown in evidence."

It is confidently asserted that in these statements the Master is clearly in error, and for the following reasons:

The only pay-roll vouchers to which the slightest criticism has been offered (except those where errors were found and eliminated by the accountants for both parties) were for the years 1900 and 1901.

These pay-rolls were investigated in the cross-examination of Complainant's Auditor.

Trans., pp. 297 to 326.

While the examination showed that no just or fair exception could be taken to them, other facts in the record show conclusively that they were reasonable, fair and just.

It will be recalled that in 1900 the company gained 1,352 new subscribers, and in 1901 gained 2,007 new subscribers.

Trans., p. 476.

During the same years there was added to construction in 1900, \$166,775.23, and in 1901, \$178,549.14.

Trans., p. 742.

During the year 1900, Complainant expended on maintenance and reconstruction, \$50,180.03, and during 1901, \$68,417.50.

Trans., pp. 393, 394, 395 and 1048.

It is also shown in the proof that, for the year 1901, there was expended on wages for maintenance, \$31,230.94.

Trans., pp. 325 and 319.

The joint accountants report the amount added to construction for each of the years 1900 to 1908, inclusive.

The Mutual Audit Company reports the amount expended on construction for each of these years, and also reports the amount expended on maintenance and reconstruction, and nowhere is there any criticism of any of these pay-rolls.

The expert accountants, on examining these construction vouchers from January 1, 1900, to December 31, 1908, found items aggregating \$2,852.39, which had been charged to construction improperly, and these were eliminated.

Trans., p. 742.

Aside from these items aggregating \$2,852.39, the accountants for both parties reported that the construction added for these years

was \$1,023,545.34, and it is entirely reasonable to assume that if these pay-rolls had been improper in any respect these accountants, or some of them, would certainly have called attention to the fact. The gain in subscribers, and the amounts expended in maintenance and reconstruction, precludes any just criticism of the amounts added to construction for those two years.

"D"

The Master criticises the evidence of Complainant in undertaking to sustain this construction account. He states that no witness was introduced who pretended to have personal knowledge as to any of these items. This statement of the Master is excepted to by the Complainant for the following reasons:

It appears that Complainant has, since before 1900 to the present time, operated a system of telephone exchanges and telephone toll lines; that its auditing department is located in Nashville, Tennessee; that it has local managers at its various exchanges, and other employes necessary to conduct the business of each exchange; that it has record showing the cost and operation of each exchange; and, also, separate accounts of the cost of toll lines.

Trans., pp. 442 and 509.

Whenever construction work is done at an exchange, or whenever any expense is incurred at an exchange, a voucher is made showing what account it properly belongs to—whether to construction, operating or maintenance. These vouchers are then approved by the manager and sent to the Auditor at Nashville. After he has audited them they go to the Assistant General Manager for his examination and approval. When they get back to the Auditor, with the approval of the Assistant General Manager, they are then distributed in the books of the Complainant, showing to what account they are chargeable.

Trans., p. 278.

Trans., p. 669.

It has never been contended, or assumed, that the Auditor has personal knowledge of whether the work has been done, or whether

the expense has been incurred, other than what he sees from the vouchers themselves. The local manager, or foreman, or other employe, who incurs the expense in the first instance, vouches for it. The Assistant General Manager, while the matter is fresh and the facts easily ascertainable, examines, and if found correct, approves the expenditure. It then goes to the Auditor, not to be approved by him, but to be entered on his books and preserved for safe keeping.

It would be impossible for Complainant to go back ten years and find the employes who incurred the expenditures and who vouched for their accuracy at the time, and it would be equally impossible for the Assistant General Manager to carry in his mind records showing expenditures at even the Louisville Exchange for a period of ten years, not considering the more than 500 other exchanges, and a system of toll lines radiating in every direction from Louisville, Ky., to New Orleans, La.

The only possible means that Plaintiff had to show the amount expended on construction, and the expense incurred at the Louisville Exchange for the years 1900 to 1908, inclusive, was to exhibit its books and sustain its books by exhibiting the original vouchers covering the entire period of time. If there is any other known way of showing the cost of construction of a property, or showing the expenses of operation, it has not been suggested by any one in this record.

The Master criticises what he calls the small amount of wages charged to maintenance or reconstruction of the Louisville Exchange during the nine years under consideration. The experts for the city have shown the amount expended by Complainant on maintenance and reconstruction of the Louisville Exchange for each of the years involved, excepting 1902, as follows:

1900.....	\$	50,180.03
1901.....		68,417.50
1903.....		51,630.75
1904.....		66,456.72

Trans., p. 1048.

Trans., pp. 393, 394 and 395.

The accountants' joint report shows that for the years 1905 to 1908, inclusive, Complainant expended on maintenance and reconstruction of the Louisville Exchange, the following:

1905.....	\$ 90,870.36
1906.....	93,423.00
1907.....	107,511.41
1908.....	86,155.98

Trans., p. 745.

Trans., p. 85.

Thus, in the eight years involved there has been expended in maintenance and reconstruction of the Louisville Exchange the sum of \$614,645.75, or an average of \$76,830.72 per year.

It must be remembered that the amount expended in the latter years was necessarily larger for the reason that there was very much more construction which was required to be kept up. In other words, taking 1900, there was only added to construction that year the sum of \$166,755.23, which, on the Master's basis, made the entire cost of the exchange at the end of 1900, only \$624,354.30. (The Master found the cost of the exchange on January 1 to have been \$457,579.07, and adding the construction for that year, gives \$624,354.30 as the cost to the end of 1900.) And in like manner, the cost of the exchange to the end of 1901, was \$624,354.30, plus the construction added in 1901 (\$178,549.14), or \$802,903.44. On our basis the result is: Cost of exchange January 1, 1900, \$678,354.69, plus construction added during 1900, \$166,775.23, gives \$845,129.92; and in like manner for 1901, \$1,023,679.06. Thus showing that the amount expended on maintenance and reconstruction for those two years was in proportion to all subsequent years.

There is no criticism in the record that a sufficient amount has not been expended to maintain the plant. Therefore, it is unjust to the Complainant for the Master to criticise the amount of wages paid out for construction, or to intimate that part of the wages paid for maintenance has been charged to construction.

There is no doubt, and no question, but what Complainant has paid out for the years involved, \$1,023,545.34, and in addition to that, it has expended for maintenance of the Louisville plant the sum of

\$614,645.75, exclusive of 1902 (the amount for that year not appearing in the record.) So that if any part of this \$1,023,545.34 is improperly charged to construction, the amount expended by Complainant in maintaining the property would have to be increased by just that amount. In other words, there is no question but that this money has been expended by Complainant, and if it has not been expended on construction, it has been expended on maintenance.

But we submit that the Master has no right to criticise, or throw suspicion or doubt upon the construction account when it appears that these vouchers were regularly made up, regularly approved, and regularly entered upon the books of the company from time to time during that period of nine years, and when the Auditor testifies that they are properly distributed and properly credited, and the Assistant General Manager testifies that he approved them as the expense was incurred, and there is, on the contrary, nothing except that for some months, in the particular vouchers examined, it did not appear that much of the wages was charged to construction, and in other months large amounts of wages were charged to construction. It is submitted that the Master does not point out any evidence upon which he bases his criticism.

There is another, and conclusive, reason why this construction account must be allowed to stand as reported. The order of the Court, in referring this case to the Master, states that "he will, under and pursuant to the equity rules and under agreements that the parties may make, proceed to take testimony, etc." The supplemental report of the Master shows that it was agreed by Complainant and Defendant, that whatever the accountants reported jointly, should be accepted as true, and no other evidence permitted to vary or contradict the same. The accountants reported jointly that \$1,023,545.34, after correcting all mistakes, *had been added* to construction from January 1, 1900, to December 31, 1908. The Master should accept this finding as well as the litigants.

"E"

Complainant excepts to the report of the Master in disallowing 10 per cent to be added to the invoice price of materials to cover freight, drayage, rentals, etc.

The proof in the case with respect to this item is as follows:

The company maintains at Louisville, Ky., a warehouse in which it stores material purchased in large quantities, and when material is drawn from this warehouse for the use of any of the exchanges or toll lines in that territory, the actual cost of the material, plus *not exceeding* ten per cent, is charged to the exchange, or toll line, to which the material goes, and "supplies" and "supply expense account" are credited with a like amount. This amount (not exceeding 10 per cent at any time) is for the purpose of paying rent, insurance, clerk hire, drayage, freight and other items of expense incurred by Complainant in purchasing, storing and distributing materials to the various exchanges and toll lines as needed. This is not a profit in any sense to Complainant. It is the actual cost to Complainant of handling the supplies from the person from whom they are bought to the time they are delivered to the exchange or toll line employees.

It is true that in the first instance the expense of handling these materials is charged in the general accounts to "supply expense," and then, when the material is issued, "supply expense account" is credited with this, not exceeding 10 per cent for handling, etc., and the exchange or toll line to which the supplies are issued is charged with a like amount.

The Master refers to the fact that he presumes that the company gets the usual trade discount for cash. Whatever trade discount the company gets reduces the invoice price of the supplies, and the records show that the *actual cost* to the company of the supplies, plus not exceeding 10 per cent, is all that is charged against the exchange or toll line receiving these supplies.

Trans., pp. 326 and 327.

There is no difference in the method Complainant pursues in handling supplies and in the method pursued by merchants. When a merchant buys goods, he must, in addition, pay the freight to get his goods to his store; he must pay his insurance, his house rent, his clerk hire, and other incidental expenses preparatory to offering his goods for sale. He, of necessity, must add this additional expense to the cost of the goods before he begins to talk about profits, and

it is only when he has added this additional expense to the invoice price of his goods that he can ascertain the real cost to him; and then on top of this must be added whatever profit he expects to make on the goods, and until he adds this he is not making any profit and could not afford to sell the goods at these prices, because it would result in his selling the goods at actual cost to himself.

This is precisely what this record shows the Complainant does. It adds not one cent of profit to the supplies.

Complainant therefore submits that the Master is in error in finding that a profit of at least \$50,000.00 has been made on the supplies furnished to the Louisville Exchange from 1900 to 1908, inclusive.

"F"

Complainant excepts to the action of the Master in discrediting and declining to accept the statement of Complainant that it has charged to construction \$10.00 per station on each station gained in the Louisville Exchange to cover the cost of labor and material in making such installation.

The evidence upon this point is as follows:

It requires material, apparatus and labor to equip each subscriber so that he may connect with the general exchange and be connected with other patrons of the exchange. It has been ascertained by experience that it cost Complainant, on the average, at least \$10.00 to install a subscriber's instrument, counting the material used from the pole in the street to the telephone instrument, thence to the ground, which covers everything in the subscriber's place of business or residence except the telephone instrument itself.

That this charge is reasonable and proper is shown from the following testimony:

Complainant's valuation of the telephone instrument is \$6.80.
Trans., p. 651.

Mr. Polk in his deposition says that the instrument is worth:

Wall set.....	\$	6.50
Desk set.....		7.50
Trans., p. 1505.		

It must be remembered that the Company only charges \$10.00 for installation, which covers everything except the instrument. Mr. Polk, in his second deposition (Trans., p. 1451), states that it will cost about \$25.00 to equip and install an instrument in a subscriber's residence or place of business. In this is included the wall set at \$6.50, or the desk set at \$7.50. Deducting the larger amount, \$7.50, leaves a charge of \$17.50, which Mr. Polk says is necessary in order to install the subscriber's instrument. As above shown, the Company only adds \$10.00 instead of \$17.50 as testified to by the expert telephone engineer for the city.

When a subscriber discontinues his service, and the telephone instrument is taken out of his house, that is all that can be recovered or saved from the expense of installation. The wire and labor of installing the instrument is lost; and in the first instance this entire expense of installing the instrument is necessarily chargeable to construction because it is part of the exchange plant and equipment, but when the telephone is removed the whole amount must be deducted from construction because that much of the construction has been lost and is no longer in existence. In order to facilitate the bookkeeping of the Company, for some period of time in the nine years under consideration, the practice of Complainant was to, in the first instance, charge all the expense and material and labor of installing a subscriber's instrument to expense of conducting the business of that exchange, and in like manner to charge to the expense of conducting that exchange the expense of removing the telephone instrument when it was given up by the subscriber. At the end of the month the net amount of increase in subscribers was charged to construction account at \$10.00 per subscriber, and a like amount credited to the expense of conducting the business of that exchange. In other words, in the first instance each new subscriber had his instrument installed and the expense of doing it was charged, not to construction, but to expense of the exchange, and at the end of the month, assuming that he still had his instrument, the expense of conducting the business was credited with \$10.00—in other words,

reduced by \$10.00—and construction charged with \$10.00, or, in other words, increasing construction \$10.00.

Trans., p. 352.

There is no difference whatever in this method of keeping the accounts and in charging to construction the expense of labor and material of installing each new subscriber, and deducting from construction the amount so charged when such subscriber discontinues his service. This \$10.00 charge did not inflate the construction account. It was simply one method, and a convenient method, of keeping the records of the Complainant so as to show the real facts, and was not intended, and did not in any degree, inflate the construction account.

"G"

The Master, on pages 13 and 14 of his report, speaks of the difference between the witnesses as to the cost of the conduit system in Louisville.

We except to the language of the Master for the reason that these witnesses he refers to are speaking of the *cost of reproduction*, and are not speaking in any respect of the *cost to Complainant* of its underground system. The Master is merely undertaking to ascertain the *cost to Complainant* of its Louisville Exchange, and not what it would cost some one else to build the plant, or what it is worth. On this branch of the case the Master is reporting solely on the cost to Complainant of its plant in Louisville.

"H"

The Master speaks (on p. 14), of the method pursued in operating, maintaining and reconstructing toll lines. Complainant excepts to this part of the report for the reason that the Master has confused the expense of conducting the business with the question he is then discussing, namely, the cost to Complainant of its plant.

This discussion, with respect to the maintenance, reconstruction and operation of toll lines properly belongs under another heading, namely, profits, or receipts and disbursements, and has nothing whatever to do with the cost of the property.

"I"

Complainant excepts to the language of the Master, on page 15, in which he undertakes to deduct from the book cost of Complainant's exchange a part of \$100,000.00 because of amounts expended on maintenance and reconstruction of toll lines.

It is immaterial how much Complainant expended in maintenance or reconstruction of toll lines and charged to the maintenance or reconstruction of the Louisville Exchange. It would not have any effect whatever upon the cost to the Complainant of the Louisville Exchange, and this is the enquiry in this part of the report.

"J"

Complainant excepts to all the language of the Master under this head of book value which relates to the cost of toll lines and toll line equipment and submits that the Master is in error for the following reasons:

It is *not* a fact that Complainant charges the cost of construction of any part of the toll lines to the Louisville Exchange. It is testified to by the Auditor of the Company, and *not disputed by any one*, that the cost of toll lines is charged to the construction of toll lines and not to exchanges.

Trans., pp. 285 and 442.

The President says that toll line and exchange construction are kept separate.

Trans., p. 509.

Again, it is shown that there are only 80 circuits, or 160 wires, used for all toll purposes coming into or going out of the City of Louisville, and a part of these are used for the purpose of giving Louisville subscribers free service to the adjoining little exchanges in different parts of Jefferson County, Kentucky.

Trans., p. 457.

"K"

It is true that the toll equipment in the Louisville Exchange Main Building is charged against the Louisville Exchange Construction

Account, and it should properly be so, and Complainant excepts to the report of the Master in declining to allow this.

It is shown in the record that this toll equipment is installed for the purpose of affording facilities to each subscriber to have connection with and use the toll lines from their individual stations. That is to say, the equipment is so arranged that the subscriber may, from his office or his residence, both send and receive toll line messages at exactly the same rate he would pay for his long distance message if he went to the central office of the Complainant, and there received or sent his toll message. In order to enable subscribers to do this it was necessary to install this toll equipment in the central exchange at Louisville, but it was a part of the Louisville Exchange equipment and put there for the purpose of serving the Louisville subscribers; and in fixing the Louisville subscribers' rates for exchange service, this was taken into consideration, and a price placed upon the use of the exchange service which would pay for a proper part of this added expense of equipping and operating the toll department in such manner as to afford this easy access of the subscriber to the toll line from his office or place of business.

Trans., p. 509.

The Master, in his report (Post. 178), says:

"The company's plant is well located, it is in excellent physical condition, and it is a remunerative business. If we compare it with the Home Telephone Company as to its earning power, it is obvious that it occupies much the superior position in this: It has extensive toll lines that connect with similar lines extending over the entire United States. Connection with these long distance lines may be had promptly by the subscribers, and this I consider a most valuable asset, and in my opinion, it will in the future, as in the past, materially aid the Complainant in its efforts to obtain new subscribers."

This finding of the Master with respect to the added value to exchange subscribers by reason of the fact that they have immediate connection with, and access to, the toll line system is in thorough accord with the testimony of the witnesses for Complainant in this record, and it fully and thoroughly sustains the testimony of the

President of the Company, who says that this was an added value to the exchange subscribers, and it can only be given to them by means of this toll line equipment in the main exchange which was put there solely for the purpose of affording the exchange subscribers easy access to the toll lines from their individual stations.

"L"

Complainant excepts to the report of the Master in adding toll line construction to the Louisville Exchange construction, of \$125,406.80.

This toll line construction is what the experts report was the cost of the entire toll line system of the Ohio Valley Telephone Company on January 1st, 1900.

Trans., pp. 756 and 1326.

This, then, was the cost of the toll line construction on January 1st, 1900, but the Master is dealing in his report with the situation in March, 1909. In the Master's report (p. 46), he states that there is some evidence, though vague and unsatisfactory, that some additions to construction of toll lines have been made since 1900.

The President of the Company testifies that whenever any one in the City of Louisville uses toll lines to any other point in Complainant's system, it uses Complainant's toll lines, and he states that the entire system of Complainant is saturated with its own toll lines.

Trans., p. 504.

The annual reports of the Company on file in the case show that for the year 1908 the gross toll line receipts of the Company were more than \$1,500,000.00. With the annual report for 1908 is filed a map showing the toll lines radiating in every direction from every important commercial center in the entire system of Complainant—from the Ohio River straight through to the Gulf of Mexico.

It is inconceivable that the Master should assume that the entire toll structure was in existence on January 1, 1900, and was only worth \$125,000.00.

Again, if the Master assumes that the entire value of the toll lines is to be added as a part of the Louisville Exchange, then what would become of more than 500 exchanges if it should be attempted to get the value of these exchanges separately or together. If the entire \$125,000.00 of toll line value is placed in the Louisville Exchange, then no other exchange of the Complainant would be chargeable with any part of the toll line construction. If the entire toll line construction should be prorated with the Louisville and the other exchanges in Complainant's system it might be argued that this would be proper treatment, but certainly the toll line value in 1900 should not be used for 1908.

The evidence is clear that the toll line construction is kept separate and distinct from exchange construction, and its cost or value does not appear in this record for the reason that Your Honor directed the Master to ascertain the cost and value of the Louisville *Exchange*, and *not* the cost and value of the Louisville Exchange, *plus* the toll line system of Complainant.

"M"

Complainant excepts to the criticism of the Master as to the refusal of the Auditor of the Company to produce the supply vouchers from the Supply Department.

Mr. Smith was asked, in his cross-examination, by the attorney for the City, to produce the vouchers from the Supply Department. He stated in reply that he had no control whatever of the Supply Department, and that he would have to refer the matter to the counsel for the Company, who was not then present at the taking of the deposition. The matter seems to have been overlooked, and nothing further said about it.

Trans., p. 362.

If the matter had been called to the attention of counsel for the Complainant, it, no doubt, would have received proper consideration; but it was open to the counsel for the Defendant to have summoned any one connected with the Supply Department and to have interrogated them with respect to any matters desired.

At any rate, it is respectfully submitted that it is hardly fair to Complainant to be criticised on what was apparently an oversight or a failure on the part of counsel for Defendant to pursue the enquiry further.

It also appears that the Mutual Audit Company's experts visited the Supply Department and had full opportunity to investigate the vouchers as much as was desired, and stated that they were not investigated for the reason that it would have taken several months to have done so.

Trans., pp. 1037 to 1038.

It also appears that the Auditor of the Company took the accountants for the Mutual Audit Company to the Supply Department and had explained to them the working of that department.

Trans., p. 1114.

"N"

The Master was directed to report the cost to Complainant of its plant and property in Louisville. The Master, no doubt by oversight, failed to report the real estate and improvements of Complainant used in its Louisville Exchange, and to this failure on the part of the Master, Complainant excepts.

The real estate owned and used by Complainant is stated in the deposition of the Auditor of Complainant to have cost to December 31, 1908.....\$ 160,841.42

Trans., p. 497 (Exhibit 21).

The Mutual Audit Company reports the cost of the real estate to December 31, 1908..... 160,841.42

Trans., pp. 1084 and 1358 (Exhibit 11-A).

Wilkinson states the cost of real estate to December 31, 1908, to be 160,841.42
Added in 1909..... 1,350.00

Total March 6, 1909.....\$ 162,191.42

Trans., p. 763.

As has heretofore been stated, it was agreed between the counsel representing Complainant and Defendant, and approved by the Master, that whatever the accountants jointly agreed to and reported should be accepted by all parties, and no evidence permitted to vary or contradict it.

The examination of the accountants "involved a close inquiry in all matters relating to the business of the Complainant in the City of Louisville, including the books, accounts, vouchers, pay-rolls, agents' reports and other original sources of information, kept at the principal office of the Complainant in the City of Nashville, Tennessee," and they reported that the plant had cost Complainant to March 9, 1909 \$1,702,391.68

This was not what the books of the Complainant showed the plant to have cost, but was what these accountants agreed the books *should have shown after errors had been eliminated*.

The books of the company showed the cost of the plant to have been 1,700,045.26
Trans., p. 475.

These accountants, having agreed upon the records of Complainant, showing the cost of the Louisville plant, excluding toll lines and real estate, should, under the agreement, be accepted, and that the cost was, as stated ... 1,702,391.68

SUMMARY.

Complainant, for the foregoing reasons, insists that the Master was in error in reporting the cost to Complainant of its plant and property in the City of Louisville, as of January 1, 1900, as on'y 457,759.07
And on December 31, 1908 1,381,124.41
And real estate of only 108,034.50

The Master should have found and reported that
 Complainant's plant cost it, as of January 1, 1900.....\$ 678,354.69

And added construction to January 1, 1909..... 1,023,545.34

Making the total cost to Complainant of its plant in
 Louisville, Kentucky, as of January 1, 1909.....\$1,701,900.03

And construction added from January 1, 1909, to
 March 9, 1909..... 491.65

Trans., pp. 762-1051 and 1340.

Making the total cost of plant to March 9, 1909.....\$1,702,391.68

And the total cost of real estate..... 162,191.42

Total "cost of plant and property," March 9, 1909\$1,864,583.10

THE MASTER'S REPORT.

II.

"The fair valuation of the plant and property of the Complainant employed in its business in said city as of March 6, 1909, and also its value at the date upon which he may file his report herein. In doing this he will state generally the basis of his estimates."

Witnesses who testified as to the value of Complainant's plant were H. Blair Smith, Auditor of the company; J. E. Jagoe, Assistant Superintendent of Complainant's plant, and the witnesses who testified on this subject on behalf of the Defendant were W. C. Polk, Wm. H. Crumb, S. D. Levings, and in addition to these, Complainant and Defendant referred frequently to the units of valuation of such properties as adopted by Prof. Jackson.

The disagreements between these various witnesses are startling. The valuations of the plant by these witnesses are as follows:

Smith's total.....	\$1,688,511.94
Jagoe's total.....	1,793,540.30
Polk's total.....	1,085,637.00
Crumb's total.....	975,000.00
Levings' total.....	1,000,000.00
Prof Jackson's total, estimated according to the units adopted by him	1,779,413.18

Messrs. Polk, Crumb and Levings are experts introduced by the Defendant. Messrs. Smith and Jagoe are officials of the Complainant Company.

However truthful these witnesses may be (and I do not question their honesty of purpose), they are all more or less biased consciously or unconsciously. It is impossible for me to reconcile these totals one with the other. It may be true that Crumb's information as to the physical plant in Louisville was, on cross-examination, shown to be defective. This may be true as to the testimony of Levings. Mr. Polk shows in his deposition that while he may have fallen into some

errors as to the quantities that constitute the Louisville Exchange, yet his experience in building plants in different parts of the country, and particularly his experience in building the Home Telephone Company's plant in the City of Louisville, entitles his testimony to consideration.

Mr. Smith speaks of and argues from the book cost of the plant, and his totals closely approximate the book cost as testified to by him.

Mr. Jagoe has gone into great detail and gives items, quantities and costs, and it is obvious that he is also largely influenced by the book cost of the Louisville Exchange. In addition to that he has added very frankly large amounts which he describes as "cost of supervision" and "overhead charges." For instance, in speaking of the value of the underground cable, he adds as "overhead charges" and "supervision," \$57,505.27. In speaking of the value of the aerial cable system, he adds as "supervision" and "overhead charges," \$89,563.98. In speaking of the value of 4,960 miles of wire and the stringing of said wire, being No. 10 and No. 14, he adds for "overhead charges" and "supervision," about \$10,000.00. And in speaking of the switchboards, he values same at \$309,000.00, but says that of this amount there are due to "supervision" and "overhead charges" \$21,462.39, or in other words, seven per cent. On page 64 of Mr. Jagoe's deposition (Trans., pp. 649-650), he is asked what supervision is necessary. Answer: "General expenses and engineering and supervision of the officers of the company." He further admits that these general expenses are every year charged to the expense of the company.

On pages 64 and 65 (Trans., pp. 649-650), he says in substance, that the salaries of said officers, which is to say, totals of General Expenses, are prorated each year among the different accounts, to-wit, Maintenance, Reconstruction and Construction, in certain proportions named by him.

In order to show further the differences in opinion of the expert witnesses, it appears that Mr. Jagoe values

the aerial cables at.....	\$ 431,953.35
Underground cables at.....	288,942.50
<hr/>	
Making a total of.....	\$ 720,895.85
Polk values these two items at.....	384,440.00
<hr/>	
Showing a difference of.....	\$ 336,455.85

Each witness undertakes to sustain his totals by elaborate details.

As stated above, the value of the plant as found by Mr. Jagoe, when reduced by the items of "overhead charges" and "supervision," amounts to just a little less than the figures given by Mr. Smith. Mr. Jagoe's figures reduced as above indicated would be\$1,625,008.66
 Which is about..... 63,000.00
 less than Mr. Smith's.

Again, Mr. Jagoe and Mr. Polk approximately agree in their estimate of the number of duct feet in the conduit system. Mr. Jagoe says there are in conduit feet..... 438,803
 Mr. Polk says there are in conduit feet..... 436,890

The difference between the witnesses as to the cost of reproduction is so large, that I find myself unwilling to adopt the figures of either. Both of these witnesses are in the highest degree competent to pass upon this question, and my endeavor has been to reconcile their statements, if possible. Being unable to do so, I have concluded, so far as the value of the conduit system is concerned, to fix the cost of reproducing the conduit system at \$.294 per duct foot, this being an average cost fixed by Messrs. Jagoe and Polk.

I have adopted Mr. Jagoe's estimate of the number of duct feet, and upon that basis, the cost of reproducing the 438,803 duct feet, at \$.294 per duct foot, with \$7,500.00 added as the cost of iron pipe found by Mr. Polk,

would be	\$ 132,821.70
Instead of the amount as fixed by Mr. Jagoe	170,382.81
Making a difference of	\$ 37,561.11
Which amount should be taken from Mr. Jagoe's total, leaving as his estimate of the value of the plant	1,587,447.55

These figures include a large amount of what the witnesses denominate "surplus equipment." This surplus is found in the aerial system, in the conduit system and in the exchange switchboards.

The evidence shows, and I so find, that it is not prudent or wise for a telephone plant like the one in Louisville, to be constructed merely to meet the immediate demands of the public; that such a plant should be built with an eye to the future, and that there should be a surplus equipment in every department sufficient to meet the demands of a period of several years, so that the wants of the new subscribers may be supplied on short notice. The evidence shows that there are more poles in the county outside of Louisville connected with the exchange or intended for the Louisville Exchange, than the present business of Complainant demands, but, as stated above, I am unwilling to condemn or to eliminate from the company's plant this surplus equipment.

Another matter was insisted upon at the argument and is referred to in the testimony that requires mention: It is stated that the blue prints of the Complainant show one or more "proposed" aerial lines, and that such lines have not been constructed, but are embraced in the estimate of the value of plant as if they actually existed. The evidence on this point is conflicting, and I have concluded not to disturb this item, although I am constrained to say that the evidence for Complainant on the question is not as clear and convincing as it might have been.

It is frankly stated by Mr. Jagoe that in all the construction, maintenance and reconstruction of the plant, "overhead charges" and "supervision" have played a part in swelling the totals. To what extent this bookkeeping device has been resorted to the evidence fails to show, except in the few concrete instances by this witness, as stated above.

I have discussed the above details of Mr. Jagoe's estimates of the value of the plant in order to show that even his figures are not convincing.

I have found that the cost of the plant was, excluding
toll lines and real estate.....\$1,381,124.41

It does not appear in evidence that in this total there is included "overhead charges" or "supervision" to any great extent.

If I am correct as to the original cost, then it is not possible that the value of the plant at this date is in excess of the cost.

The witnesses are asked "what kind of depreciation has occurred in the plant," and in this way it was sought to obtain its true value. The witnesses for Complainant all agree that the plant has been kept up in excellent condition, and on account of the care that has been exercised in respect of the maintenance and reconstruction, the value of the plant is approximately equal to its cost price. Witnesses for the Defendant, however, state that the depreciation from the cost price has been about twenty or twenty-five per cent.

— The plant in Louisville was begun and finished about the year 1890, and has therefore been in operation for about twenty years. The evidence shows that a great many of the parts of the exchange or plant will become useless in one year, and as to these parts, the testimony is that they have been maintained or reconstructed. Other parts of the plant will last a number of years, varying according to the character of material. All these parts, however, have been well cared for, and for all practical purposes, the Louisville Exchange in all its parts, performs well the functions of a new plant, and is nearly equal physically to a new plant.

But in spite of all this, it is a matter of common knowledge that poles and wires and instruments and switchboards and all the apparatus connected with a telephone system, under the incorrigible law of nature, begin to depreciate the very day they are installed; and this depreciation continues from day to day and from month to month until the parts require replacement. Under the evidence poles will become worn out on an average in about ten years, and it is reasonable to suppose at this date there are not many poles in the system that were in use in 1890—new poles having taken their place from time to time as the exigencies of the service demanded.

The evidence shows that the underground or conduit system will last unimpaired indefinitely, as some of the witnesses put it, more than fifty years. The conduit system was installed by the Ohio Valley Company some years before 1900, and it has required very little expense for maintenance or reconstruction since it was acquired by Complainant. About fifteen per cent has been added since 1899.

The estimates of the witnesses as to present value are irreconcilable. It may be conceded that the opportunities of some of the witnesses for accurate knowledge on the subject are superior to those of others. This assumption is undoubtedly true. I would not be fair in assuming that either of the witnesses is guilty of knowingly making misleading statements.

Convinced as I am that my finding as to the cost of the plant is correct, I am, for the reasons stated, persuaded that the value of the plant as of March 6, 1909, all features of depreciation considered, ought to be and is.	\$1,381,124.41
Less depreciation of ten per cent.....	138,112.44
Leaves.....	<u>\$1,243,011.97</u>

This does not embrace real estate nor toll lines nor working capital, if any should be allowed.

The value of plant, after considering depreciation, I find to be.....	\$1,243,011.97
Value of toll lines and equipment.....	125,406.80
Less depreciation of ten per cent.....	12,540.68
Net value.....	<u>\$ 112,866.12</u>

I find therefore that the total value of the exchange, including the toll lines, but excluding real estate, as of March 6, 1909	<u>\$1,355,878.09</u>
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There is some evidence—though vague and unsatisfactory—(See Smith's Deposition, p. —) that some additions to construction of toll lines have been made since 1900, but the only special line mentioned is one from Louisville to Nashville. This entire line can not be considered as a part of the Louisville Exchange construction. Its cost is said to have been \$40,000.00, but all of this can not be charged to Louisville toll lines. Half of it at least must belong

to Nashville, and there are other exchanges tapped by it between the termini, such as Bowling Green, Elizabethtown, Franklin and Edgefield.

I see no reason to doubt that the value of the plant as of the first of November, 1910, is not of much less value than I have found it to be as of date March 6, 1909.

If Complainant in the past twenty months has maintained and reconstructed its plant as carefully and as elaborately as it did during 1905, 1906, 1907 and 1908, the plant ought to be worth approximately as much now as it was on March 6, 1909.

EXCEPTIONS OF APPELLEE.

The Master reports that on March 6, 1909, the *plant*
was worth.....\$1,243,011.97

That the toll lines and (toll) equipment was worth.... 112,866.12

Supra p, 46.

The Master made no report with respect to the value of the real estate.

Complainant excepts to this report of the Master in reporting the value of the plant March 6, 1909, to have been only \$1,243,011.97. He should have reported the value, exclusive of real estate and toll lines, to have been at least \$1,702,391.68

Complainant's evidence on this branch of the case is the depositions of:

James E. Caldwell, President of the Complainant.
H. Blair Smith, Auditor of the Complainant.
Leland Hume, General Manager of the Complainant.
J. E. Jagoe, Assistant Superintendent of Plant of Complainant, and
Stipulation with respect to units of value used by Prof. D. C. Jackson.

Defendant's evidence is the depositions of:

W. C. Polk, a telephone engineer.
Wm. H. Crumb, a telephone engineer, and
S. D. Levings, editor of a telephone journal.

"A"

EVIDENCE FOR COMPLAINANT.

All of these witnesses exclude real estate and toll lines, in fixing the value of the exchange plant.

JAMES E. CALDWELL.

This witness is the President of Complainant, and has been actively engaged in the telephone business with Complainant since 1885. Until about four years ago he was both President and General Manager, and since that time its President.

Trans., p. 498.

Its properties, except such as have been acquired by purchase or consolidation, have been built under his direction and supervision.

Trans., p. 498.

He states that the Louisville plant has been built with a view of being "permanent and of the very best character;" also "with reference to the growth of a city the size of Louisville, and importance of Louisville, giving evidence of its future."

Trans., p. 504.

He states that the plant in Louisville is worth, excluding real estate \$1,702,391.68

Trans., p. 507.

LELAND HUME.

This witness has been engaged in the telephone business with Complainant for twenty-five years. He has been its Treasurer, Secretary, Local Manager at Memphis Exchange, for ten years Assistant General Manager, and for the past four years General Manager.

Trans., pp. 667-668.

Most of Complainant's properties have been built under his direction and supervision.

The annual report of Complainant for 1909, filed in this record, shows that Complainant had on December 31, 1908, five hundred and twenty-seven exchanges, and a comprehensive system of toll lines throughout its territory, from the Ohio River to the Gulf of Mexico.

This witness has been familiar with the Louisville plant since June, 1899. It has been extended and developed with the greatest care and economy.

Trans., pp. 668-669.

He has supervised and approved all vouchers for constructing and operating this plant since before January 1, 1900.

Trans., p. 669.

He examined the figures presented by Mr. Jagoe, Assistant Superintendent of Plant, as they were made up from time to time, and which will hereinafter be referred to more particularly, and he states that these figures are very conservative, and that it would be difficult for practical men to reproduce the plant at the figures given.

Trans., pp. 669-670.

He, of all men, has the best right to state its present value, and he does so, and says it is worth, excluding real estate

\$1,793,540.30

H. BEAIR SMITH.

This witness is now, and has been for more than ten years, the Auditor of the Complainant. He has devoted his time to auditing the cost of constructing toll lines and exchanges. During all that time he has been engaged in examining vouchers for operating, maintaining and reconstructing toll lines and exchanges; during that long period of time he, of necessity, has acquired very large experience and knowledge of Complainant's properties, their cost and value; and while he is only an Auditor, and not engaged in the actual construction or operation of telephone plants, yet his large experience in handling telephone accounts, and especially of the Complainant company, entitles him to have an opinion of the value of this plant, and that opinion is entitled to weight.

He states that the Complainant's plant in Louisville is worth, and cannot be reproduced for less than.....\$1,700,045.36
Trans., p. 221.

J. E. JAGOL.

This witness states that he is Assistant Superintendent of Plant of Complainant, and reports directly to the General Manager, who is the acting Superintendent of Plant.

Trans., pp. 621-622.

He made a study of the Louisville plant from the middle of January to a few days before his deposition was given on March 18, 1910.

Trans., p. 622.

He gives in great detail the exact quantities of material in the plant, and gives the value of each item in like detail.

His valuation of the plant, excluding real estate, office furniture and fixtures, working capital, supplies on hand, teams and tools, was\$1,793,540.30

Trans., p. 635.

This is the only witness in the record who undertakes to give *exact quantities of material in the plant* and does not rely upon *estimates*, as do all the witnesses for the Defendant.

His deposition shows that he has made a careful and accurate inventory of the plant in Louisville. He states certain things which ought to be recognized without any evidence. Among other things, he says that the number and size of the poles actually in use in an exchange must be known before a proper valuation can be placed thereon.

Trans., pp. 625-626.

The cable used must be ascertained before valuation can be had, because different sizes of cable vary very greatly in price, and until the exact lengths and sizes of cable are ascertained it is impossible to place a valuation thereon.

Trans., p. 629.

And finally this witness says: "There is an individuality about every plant that you cannot separate from it. There are conditions in every city that are different from the conditions in every other city, and one of the biggest features that often escapes attention is the class of service given. We can serve ten thousand subscribers of one class for one-third of the construction expense that we can serve ten thousand subscribers of another class; and then it is possible to give connection to subscribers at one price and then, by increasing the efficiency of the service, or the reliability of the service, to add fifty per cent to the construction value."

Trans., p. 631.

He says that there is a difference in the cost of telephone plants in the same city; that it does not convey any intelligent idea of the value of one plant to talk about the value of the other plant; that the cost of one has no bearing upon the cost of the other, no more so than it would be proper to say that the ability of every lawyer is the same; that no man, expert or otherwise, has a right to undertake to value a telephone plant as large as Complainant's plant in Louisville without accurate knowledge and a thorough investigation of it.

Trans., pp. 632-633.

He says "that a plant can be built in Louisville to serve ten thousand subscribers for \$1,100,000.00, but that it would depend upon the character of material used and the work done—the character of the material and stability of the plant and the class of service that the plant would be equipped to give."

Trans., p. 632.

The plant was valued by him as of March 18, 1910.

Trans., p. 631.

There has been no addition to the plant since March 9, 1909, and that it is worth slightly less in March, 1910, than it was in March, 1909.

Trans., p. 626-627.

In arriving at a classification of the materials used in this property, he used the classification adopted and in use in all of the large telephone companies in America.

Trans., p. 627.

The value or cost of erecting different kinds of material in this plant was arrived at by actual experience. In speaking of the method pursued in getting the value of the cable in the plant, he says that a part of the cable work has been done in Louisville since he has been with Complainant, and that certain parts of those cables have been replaced and that "the cost of doing all work in Louisville during the past two years that I have had supervision of, has been used in assembling the units which we are using in this estimate."

Trans., p. 644.

With respect to fixing the value on the poles, he says:

"I know what it cost our company during the past four years to purchase and erect similar poles, and that is the amount I have given, and besides that, it seems to be the consensus of opinion among all companies, for when we buy or sell a half interest in poles to friendly companies, where we go into a joint pole agreement, the average price paid for the past two years on forty-foot poles has been \$22.50 per pole, and that does not include the cross arms, simply the bare pole with the guys."

Trans., p. 646.

The valuation placed by Mr. Jagoe on forty-foot poles in Louisville, including the cross-arms, etc., is \$23.92 each.

Trans., p. 635.

The inventory value of the plant by the witness is full, complete and is in the greatest detail, both as to quantities and the units of value used in arriving at a total valuation.

The Master seems to have been impressed with this witness, and would no doubt have accepted his valuation, but that this witness includes as a part of his total valuation the expenses of organization, cost of engineering, supervision, freight and other expenses necessary to be incurred by any one in building so large a property. The Master does not think any such item of expense should be allowed in valuing the property. It is sufficient for the present to state that all these items of expense are universally recognized as proper; no plant can build itself; there must be an organization; there must

be engineering plans, foremen, interest on capital while the plant is building; expense of tools and teams which wear out during the time of construction, claims for damages, legal expenses, securing rights-of-way, tree trimming privileges and numerous other known items of expense, as well as certain, but unknown, contingencies.

On page 44 of the Report the Master says:

"It is frankly stated by Mr. Jagoe that in all the construction, maintenance and reconstruction of the plant 'overhead charges' and 'supervision' have played a part in swelling the totals. To what extent this bookkeeping device has been resorted to, the evidence fails to show, except in the few concrete instances mentioned by this witness as above stated."

The Master is here confused again.

There is no question of maintenance or reconstruction involved in this inquiry. The only question the Master is undertaking in this branch of his report to deal with is "the present value of the plant."

The cost of the plant is placed on its books without any allowance for supervision, engineering services, rights-of-way, interest on money, or overhead charges. There is no proof to the contrary.

Trans., p. 679-770.

The Master has, in the former part of his report, dealt with the question of cost to Complainant of its plant, and is now dealing with the question of what the plant is worth, or, as is sometimes stated, the cost of reproduction.

For the present, it is sufficient to state that the Master is in error in declining to allow, under this inquiry, any overhead charges to be added to the actual cost of the material and the labor of placing it in position. This question will, however, receive consideration in another part of these exceptions.

An examination of the deposition of Leland Hume, General Manager, fully sustains all that Mr. Jagoe says with respect to the

necessity of knowledge of the particular plant, its individuality and other matters relating to the ascertainment of value. No witness in this record testifies to the *contrary*.

PROF. D. C. JACKSON.

Prof. Jackson is a member of the Society of American Institute of Electrical Engineers, the American Society of Mechanical Engineers, and the American Society of Civil Engineers, formerly professor of Electrical Engineering of the University of Wisconsin, and later professor of Electrical Engineering in the Massachusetts Institute of Technology of Boston; he was the Chairman of the Telephone Commission appointed by the City of Chicago in 1907 to investigate the telephone conditions in that city, to prepare an estimate of the value of the telephone plant, to determine what it would cost to build an adequate plant, what the expense of conducting such a plant would be, and what rates would be reasonable and fair for the city to impose upon the operating company.

Report of City Council Committee, Trans., p. 824 *et seq.*

During 1908 and 1909 he was engaged under the employment and direction of the Massachusetts Highway Commission in preparing an inventory and valuation of the entire properties of the New England Telephone Company in the State of Massachusetts.

In order to value the plant of the New England Company in Massachusetts, after having ascertained quantities of material throughout the State, embraced in the various plants, it became necessary for him to ascertain units of cost for the various kinds and classes of material in the plants. And if his units of value are applied to the classes and quantities of material actually ascertained to exist in the Louisville plant by Mr. Jagoe, and excluding everything that Mr. Jagoe excludes, and only including what Mr. Jagoe includes, the valuation of the Louisville plant will be found to be, as stated by the Master on p. 41 of his report, \$1,779,413.18.

A careful comparison of the value of the Louisville plant between Mr. Jagoe and Prof. Jackson is developed in the deposition of Mr.

Jagoe. Therein Mr. Jagoe points out that in some instances his units of value are higher than Prof. Jackson's and in other instances Prof. Jackson's units of value are higher than Mr. Jagoe's. This comes about because of the dissimilar conditions under which the Louisville and Massachusetts plants are erected. As illustrative of this point, Mr. Jagoe gives the total value of the poles in the Louisville plant at \$331,769.40, or \$23.92 each.

Trans., p. 635.

Applying Prof. Jackson's unit of value, he has a valuation of only \$190,379.62.

Trans., p. 630.

This is accounted for by Mr. Jagoe as follows:

"Prof. Jackson's unit of cost includes every pole in Massachusetts, including the twenty-five-foot pole out in the country routes. After we leave the city, the average pole is possibly about 25 or 26 feet, and the cost of them is about \$6.50 each. Mr. Jackson used, of course, these poles, as well as the city poles, in his estimates."

Trans., p. 630.

The poles in the City of Louisville are forty-foot poles, and this makes a great deal of difference in the cost. The cost of the pole itself and the cost of erecting the pole is always in a much larger proportion than the lengths. A fifty-foot pole would possibly cost five times as much as a twenty-five-foot pole.

Trans., p. 626.

The valuation of the Louisville plant, using Prof. Jackson's units of value, is not a mere estimate, but is the application of actual units of cost to actual known quantities of material; and this valuation, using Prof. Jackson's units, is entitled to great respect.

His valuation of the plant is \$1,779,413.18

No one of Complainant's witnesses includes real estate, or working capital.

"B"**EVIDENCE OF THE DEFENDANT.**

All the Defendant's witnesses exclude toll lines and real estate, in fixing the value of the exchange plant.

W. H. CRUMB.

Mr. Crumb is a telephone engineer and a contractor for erecting telephone properties.

In direct examination he states that he had made a "very careful inspection of the plant," but on cross-examination shows that he had not even made a superficial examination of the plant in Louisville.

Trans., p. 876.

He attaches an affidavit as an exhibit to his deposition in which he states that the Louisville plant could be duplicated for one million dollars new, and in his cross-examination shows that he made this affidavit without the slightest knowledge of the plant.

Trans., pp. 952 to 957.

After giving this affidavit, he made two additional visits to the City of Louisville, but they were shown to have been so limited in time, and his investigation and examination of the plant so meager, that his testimony is an insult to the intelligence of the Court. It was discredited by the Master.

W. C. POLK.

Mr. Polk gave two depositions. His first one was given in January, 1910, following the deposition of Mr. Crumb given in October, 1909. Mr. Polk has been a telephone engineer for fifteen years.

Trans., p. 1492.

He was chief engineer of the construction company that built the Louisville Home Telephone Company's plant in Louisville in 1901 and 1902.

Trans., p. 1493.

The knowledge acquired by him in 1901 and 1902 does not entitle him to speak as of March 6, 1909, when plant was changed and added to. He states:

"In the first place government statistics are four or five years behind, and the telephone business is developing so rapidly that statistics four or five years old do not apply."

Trans., p. 1415.

The only inspection of Complainant's plant made by Mr. Polk was "a casual examination the last couple of days, in a general way."

Trans., p. 1495.

This is his entire knowledge of the plant except what he saw while building the Home Company's plant in 1901-02, with the exception of an examination of some blue prints attached to the deposition of Mr. Crumb, showing existing and proposed cable routes in Complainant's Louisville plant, which were incomplete, and delivered to Mr. Crumb with the statement that they were incomplete.

Trans., p. 883.

He also stated that he made no physical examination of the property, but did examine these incomplete blue prints of the cable system and obtained his quantities of cable therefrom.

Trans., p. 1512.

He says:

"As I understood my employment, all I prepared for was to place a valuation on the plant, and not to make a report on its physical condition."

Trans., p. 1513.

And again:

"I stated that I had made no specific examination so far as to determine the present value from a depreciated standpoint, but taking what I know of a going concern, *as a general proposition*, and the way they are kept up, and knowing the general character of the Cumberland, and the way they

are doing work, I consider 20% as a reasonable amount, exclusive of real estate."

Trans., p. 1410.

From this meager data and information, he gives a total valuation of the Louisville plant of\$1,052,800.00

This, however, does not include real estate, or any overhead charges of any kind, such as supervision, interest and other items.

Trans., pp. 1516-1517.

After the deposition of Mr. Jagoe had been taken and filed, and after Mr. Polk had examined it, he gave another deposition, in which he begins with an admission of errors in his calculations given in his first deposition, and undertakes to explain how these errors were made. They were all, however, against Complainant.

He next attributes an improper motive to Mr. Jagoe in classifying the materials in the Louisville plant.

Trans., pp. 1388-1394.

On cross-examination he is forced to withdraw his statements when it is shown that his criticisms of Mr. Jagoe are unjust and unfair, and that he was acting upon misinformation.

Trans., 1422-1423 and 1426.

Mr. Polk, after correcting *admitted* errors, increases his former estimate of value from \$1,052,800.00 to\$1,195,737.00

Trans., p. 1411.

This change in valuation seems to have escaped the attention of the Master.

When it is pointed out in the deposition of Mr. Jagoe that by actual count the number of poles in the Louisville Exchange is 13,870 (Trans., pp. 625-635), Mr. Polk still insists upon estimating only 11,000 poles to be in the Louisville plant, although he has not under-

taken to count them, but says that this ought to be a sufficient number of poles to take care of the subscribers in the Louisville plant.

Trans., p. 1401.

He admits that he is using the price of cable at the date of his deposition under instructions of the City Attorney, although cable as late as 1907 was twenty per cent higher than at the present time, and does not use the average price over a period of years because he says he was instructed by the City Attorney to use present prices.

Trans., p. 1424 and 1425.

He says (see Trans., p. 1394) that Mr. Jagoe had overstated the price of the large items of cable, and had understated the price of the small items of cable, but had to admit (see Trans., p. 1427) that the facts were just the reverse, and that in the smallest quantities of cable the price fixed by Mr. Jagoe was higher than his prices, and on the largest quantities of cable Mr. Jagoe had fixed a price less than he had fixed.

It appears in the record that a telephone property is never a finished or completed plant. That as the city grows and subscribers increase, additional and new construction must be added year by year, and that of necessity a telephone plant must, after the initial installation, be added to by "piece-meal" construction. In speaking of this "piece-meal" construction, which he admits is necessary, he is asked this question:

"Q. Is it fair to a company that has invested its money in a plant, kept up with the growth of the city, and taken care of the business by piece-meal construction, to say that it can only have a return on what it would cost to build the plant over new again?

A. No, sir; I don't think that is fair.

Q. That is an unjust and unfair thing?

A. Yes, sir."

Trans., p. 1436.

Both Mr. Polk and Mr. Crumb place a much smaller valuation upon the various switchboards used by Complainant in its Louisville plant than do the witnesses for Complainant. Their

idea is that other switchboards built by other manufacturers are intended to serve the same purpose, and that, in their opinion, these switchboards built by other concerns named by them should be used.

It also appears in the record that Complainant purchases its switchboards from the Western Electric Company, because it believes that they are the best, have the longest life, and are more satisfactory in a telephone plant.

Trans., p. 633-4.

There is no controversy in this case as to what the cost of the Western Electric Company's switchboards are, and Complainant's witnesses base their value upon the Western Electric Company's switchboards, which accounts for a considerable item of difference between their values and those of the city's witnesses, Messrs. Crumb and Polk.

Complainant's officers have been engaged in the business for a quarter of a century; they have had largely more experience than either Mr. Crumb or Mr. Polk, exercising their own good judgment and spending the money of their stockholders, they have thought it best to purchase the Western Electric Company's switchboards. It cannot be possible that this valuation is to be reduced because some person has the opinion and idea that another switchboard costing less money is just as good.

Mr. Jagoe states that a telephone plant serving ten thousand subscribers in the City of Louisville can be built for \$1,100,000, but it would not be the plant that Complainant has in that city.

Trans., p. 633.

In this connection he states: "A telephone plant is not different from any other property, real estate, or any other kind of property. You can build a four-room house for a couple of hundred dollars, or you can build it for a couple of thousand dollars. The telephone plant is similar to any other property in that way. The better you make the plant the more expensive it is, and one peculiar condition is that you can get service up to a certain point very cheaply

to everybody, *but* you add to the efficiency; if you add 5 per cent to the efficiency, you will add more than 5 per cent to the cost, for the last 10 per cent of efficiency of your service will amount to 50 per cent of the cost of your plant."

Trans., p. 661.

Nowhere in the record does any witness undertake to contradict or explain away this statement. Mr. Polk admits that he has not sufficient knowledge of Complainant's plant in the City of Louisville to be able to determine or express an opinion upon its condition.

He is asked the following question:

"Q. Did you intend to say, or do you now say anything about its present value?

A. I do not, only in an offhand way; I made a statement this morning that as a general average a concern going for several years, moderately maintained, will run down 20%.

Q. Don't you think it will be better to say that you have no knowledge of the present condition of the plant and of the relative value compared with the replacement value?

A. I didn't say I had any knowledge. I had not made investigation.

Q. Then you don't wish to have any opinion stated in your deposition as to the present actual value of the Complainant company's plant in this suit?

A. No, sir; not as a specific proposition."

Trans., p. 1418.

Mr. Polk, having it pointed out by the witness that Complainant did use No. 10 iron wire in its Louisville plant, declined to allow any in his estimate, and insisted upon using the cheaper wire, No. 14.

Trans., p. 1415.

Trans., p. 634.

Trans., p. 845.

Mr. Polk, in his second deposition (see Trans., p. 1408), says that he estimates the value of private branch exchanges and sub-station equipment, etc., at \$128,775.00, or an average of \$13.70 per station,

and later (see Trans., p. 1449) states that the cost per station is about \$25.00, thus making a clear error against the Complainant of more than \$106,000.00.

An examination of the deposition of Mr. Jagoe, in which he points out the exact quantities and qualities of cable, and points out the specific and direct errors made by Mr. Polk in his first deposition, in estimating quality and quantity of cable in Complainant's plant, was submitted to Mr. Polk, and, in his second deposition, while admitting errors on his part, and admitting the correctness of what Mr. Jagoe had stated, yet declined to change his valuation based upon an incomplete knowledge of what quantity and quality of cable was actually in the plant. This is not a minor difference between them.

Mr. Jagoe shows that the company actually had in use in the Louisville plant one hundred and twelve private branch exchanges.

Trans., p. 650.

Mr. Polk admits that he only estimated seventy-five, and declines to correct his statement, although he admits that he has no knowledge of the actual number in the plant.

Trans., pp. 1408 and 1409.

The Master, in comparing the difference in value of cable between Mr. Jagoe and Mr. Polk (*supra* pp. 42-3), uses the values given by Mr. Polk in his first deposition, which in his second deposition Mr. Polk admits to be erroneous and undertakes to partially correct.

Trans., p. 1411.

In this way, the Master has inadvertently made an error of more than \$46,000 against Complainant.

S. D. LEVINGS.

This witness was a clerk in an engineer's office in the City of Chicago until shortly before his deposition was given in New York, at which time he was the editor of a telephone journal. He shows very clearly that he has no knowledge of Complainant's plant in Louisville, and his attempted estimate of valuation of Complainant's plant is not worthy of serious consideration.

It thus appears that the only two witnesses introduced by defendant to testify as to the value of Complainant's plant in Louisville were not familiar with the property, made no examination of it with a view of ascertaining its value, and are testifying from their general knowledge of telephone conditions throughout the country, and are paid expert witnesses.

Their interest on behalf of their clients was certainly as great as the interest of Complainant's officers and employees on its side.

The general experience in the telephone business of Messrs. Polk and Crumb is far less than that of Complainant's officers. If Messrs. Polk and Crumb may testify as to the value of the plant because of their experience in the telephone business generally, and if their opinion of value is to be treated seriously, what is to be said of the opinion of Complainant's President, General Manager, Auditor and Superintendent of Plant.

It must also be remembered that the testimony of Messrs. Polk and Crumb shows that their experience generally has been with companies building exchanges *for sale*, and the experience of Complainant's officers has been with building exchanges to operate.

The standing of Messrs. Polk and Crumb, however high it may be for ability or integrity, is not superior to that of the Complainant's officers, who have for twenty-five years received the confidence and trust of a board of directors; men who have successfully managed a great property for more than a quarter of a century; surely their opinion and their judgment and their testimony is of as great weight as that of Messrs. Polk and Crumb, assuming that they all had *equal means of knowledge*. But when it is remembered that Messrs. Polk and Crumb do not pretend, or assume to have the knowledge that Complainant's officers and witnesses have, it is readily seen that any discrepancy in the testimony is easily reconcilable upon the theory that Complainant's witnesses testify from *actual knowledge and facts*, while Messrs. Crumb and Polk testify from theories and general conditions, as they understand them, throughout the country, without

reference to any knowledge of the particular plant about which they are undertaking to testify.

It thus appears that Complainant's witnesses have superior knowledge and experience, and no greater interest as witnesses.

Mr. Hume, in his deposition (Trans., p. 678), quotes with approval the following extract from a pamphlet which is entitled "Valuation of Public Service Corporations," by W. H. Williams, and appears to have been a paper read by him for discussion by joint session of American Economic Association and American Political Science Association, Chamber of Commerce, New York, December 30, 1909, where it is said:

"The cost of reproduction is a matter of individual opinion; no engineer in estimating on the several important items of construction work for the year will come within ten per cent of the total aggregate cost. Many of the more important items are frequently underestimated from twenty-five to fifty per cent. Experienced engineers, knowing the local conditions, cannot estimate the exact cost, how can those without special knowledge be expected to do so? A very good illustration of this may be had by contrasting the original estimates with the ultimate cost of postoffices and other public buildings. An especially good illustration, and one known to all readers of the daily press, is that of the Panama Canal. The original estimate of the cost of engineering and construction work was \$139,705,200, but the present estimate is \$297,756,000, and it is probable this cost will be greatly exceeded."

It, therefore, appears that according to the Complainant's President, General Manager, Auditor, Assistant Superintendent of Plant, and Prof. Jackson, *this plant was worth on March 6, 1909, more than \$1,700,000*, and that the evidence introduced by the Defendant consists of depositions from two telephone engineers, who have no superior experience in the telephone business, nor the necessary knowledge of Complainant's plant in Louisville to entitle their opinion to serious consideration. They only purport to speak as expert witnesses without a knowledge of the actual facts and conditions.

Therefore, it is insisted that the Master was in error in placing a valuation on Complainant's plant as of March 6, 1909, of \$1,243,011.97

He should have found and reported that Complainant's plant was, on March 6, 1909, exclusive of real estate and toll lines, worth at least the sum of \$1,702,391.68

"C"

Complainant excepts to the statement of the Master in which he declines to allow any "overhead charges" in estimating the present value of Complainant's plant.

The Master says, p. 44.:

"It is frankly stated by Mr. Jagoe that in all the construction, maintenance and reconstruction of plant, overhead charges and supervision have played a part in swelling the totals. To what extent this bookkeeping device has been resorted to the evidence fails to show except in the few concrete instances mentioned by this witness as above stated."

It has heretofore been shown that there are no overhead charges of any kind upon the books of Complainant.

Trans., pp. 679 and 770.

However, in this connection, the Master is considering only *value*, not *cost*. Therefore if any such charges *had* been entered upon its books, it would not be pertinent to the present inquiry, viz.: The present *value* of the plant.

Under this head, the Master is considering a property that has been erected under a proper organization, after proper engineering plans had been prepared, after a franchise, or permission of the city authorities had been obtained, after a legal organization had been perfected, after sufficient securities had been sold to provide funds with which to erect the plant, its supervision during the progress of its construction, the tools and teams necessary to use in its

construction, but which really wear out by the time the plant is constructed; attorneys' fees, claims for damages, tree trimming privileges, insurance, interest on money, and various other items of expense which are necessarily incurred in the building of the plant, and over and beyond all this, the advertising, canvassing and other means adopted to secure patronage so as to have an established going business.

It is the value of a plant which has incurred all these expenses that the Master is now considering.

No witness in the record intimates that it is not proper to include these items of expense in arriving at the present value of the plant. Mr. Polk, the main expert telephone engineer on behalf of the Defendant, allows in his amended estimate for overhead charges the sum of.....\$ 90,000.00

Trans., p. 1411.

The Chicago Commission, composed of three telephone engineers, after a careful study from January 7 to April 3, allowed overhead charges of about 20 per cent of the cost of the plant.

Trans., p. 825.

In this report the Commission allows:

Supervision and engineering	\$ 700,000.00
Interest and insurance	600,000.00
Brokerage in selling securities	1,877,333.00
Or a total of	\$3,177,333.00

The total value of the plant, including these items and real estate, is.....18,773,333.00

The estimate furnished this Commission by the Manufacturers' Telephone Company in estimating the cost of construction of a plant they proposed to erect, provided overhead charges as follows:

Supervision and engineering.....	\$ 600,000.00
Interest and insurance.....	550,000.00
Brokerage.....	687,300.00
	<hr/>
	\$1,837,300.00

Total cost of plant, including real estate and fore-
going items.....14,983,300.00

Mr. Jagoe, in his valuation of plant, allowed less than 15 per cent overhead charges, and excluded from his valuation teams and tools, working capital, supplies and furniture and fixtures, and if these items had been included and deducted from the overhead charges allowed by Mr. Jagoe, it would have reduced the overhead charges to considerably less than 10 per cent.

That all these items of expense are necessary in estimating and valuing a going plant is so self-evident that we submit that the Master was in error even though there was no proof sustaining these items in the report, and for these reasons Complainant excepts to the Master's report in disallowing any of these items of expense.

"D"

Complainant excepts to the report of the Master in not allowing as a part of the present value of the plant the expense of securing business, franchise value, right-of-way, tree trimming privileges, tools and teams, supplies, office furniture and fixtures, and working capital.

Mr. Polk, in his second deposition, admits that all of these items of value are right and proper.

Trans., p. 1438.

The Chicago Commission concedes and allows these items in fixing the valuation of the Chicago plant.

The Manufacturers' Telephone Company, in their estimate, both original and amended, allow these items.

It is apparent that a plant cannot be operated, maintained and

reconstructed without having on hand supplies. It cannot be maintained, constructed or reconstructed without the use of tools and teams, office furniture and fixtures. It cannot do business until it has procured the consent of the municipality. It cannot serve patrons until it has secured patrons, and necessarily the expense of securing patronage is a part of the cost of the plant, and is entitled to be capitalized. No property can be operated without having on hand a working capital.

All of these items the Master disallows, and Complainant excepts to this part of his report, and insists that he should have allowed all of these items in arriving at the value of the plant.

"E"

Complainant excepts to the report of the Master in ascertaining the value of Complainant's toll lines to have been on March 6, 1909, only \$112,866.12.

Supra. p. 46.

The accountants ascertained that the cost of the toll lines, purchased by Complainant from the Ohio Valley Telephone Company in June, 1899, was \$125,000, and the Master assumes this to be the value of *all* toll lines on March 6, 1909, *less* 10 per cent depreciation.

Complainant owns and operates five hundred and seventeen exchanges all connected together with a system of toll lines.

Trans., pp. 208 and 209.

The cost of building toll lines and exchanges is kept separate and distinct.

Trans., pp. 211, 508 and 509.

The Master has erroneously assumed that no toll lines have been built since January 1, 1900, and that the toll lines in existence on that date have depreciated in value 10 per cent.

There is no evidence of the value of Complainant's toll line system

in the record for the reason that the Master was not directed by the Court to ascertain such valuation, and, therefore, no proof was introduced upon this point.

The Master (pp. 46-7) says:

"There is some evidence—though vague and unsatisfactory—that some additions to construction of toll lines have been made since 1900, but the only special line mentioned is one from Louisville to Nashville. This entire line cannot be considered as a part of the Louisville exchange construction. Its cost is said to have been \$40,000—but all this cannot be charged to Louisville toll lines. Half of it, at least, must belong to Nashville, and there are other exchanges tapped by it between the termini, such as Bowling Green, Elizabethtown, Franklin and Edgefield."

The discussion with respect to the toll line from Nashville to Louisville was incidental entirely to another question which had arisen, and was not in connection with the construction of Complainant's plant in Louisville.

Trans., p. 444.

Notwithstanding the fact that the Master insists that the toll line between Louisville & Nashville belongs to all the exchanges between these two cities, yet, after ascertaining the value of the toll lines owned by the Ohio Valley Company on January 1, 1900, the Master, instead of prorating this value among the nine exchanges owned and operated by the Ohio Valley Company at that time, has allotted to the Louisville Exchange the entire value of the toll line system of the Ohio Valley Telephone Company.

That this is improper treatment is so manifest that no proof is necessary to overthrow it, and Complainant excepts to the action of the Master in respect to his method of ascertaining toll line value, and its apportionment to the Louisville Exchange.

"F"

Complainant excepts to the report of the Master in that it fails to report the value of the real estate and improvements thereon, which constitute a part of the Louisville Exchange.

This real estate has cost to March 6, 1909, the sum
of.....\$ 162,191.42

Its value is equal to its cost.

Dep. of Burton (Trans., p 969).

Dep. of Brand. (Trans., p. 978).

The Master should, therefore, have reported the value of Complainant's real estate and improvements thereon, which constitutes a part of the Louisville Exchange, and having failed to do so, Complainant excepts.

"G"

Complainant excepts to the report of the Master in not allowing anything for "Supplies" and "Working Capital."

It is apparent that these things are necessary in order to conduct a business. There must be supplies on hand to care for the plant from day to day; there must be *some money* on hand to handle the business. All these things are recognized and allowed by the different experts. Mr. Polk says that he thinks that supplies and furniture and fixtures should be allowed to the extent of \$20,000.00, and that there should be from \$10,000.00 to \$20,000.00 for working capital.

Trans., p. 1410.

The Chicago Commission allowed in a plant costing \$18,773.-333.00, including real estate, tools and supplies, furniture and fixtures, supervision and engineering, interest and insurance, bank balance and brokerage, the following amounts:

Tools and supplies.....	\$ 250,000.00
Bank Balance.....	300,000.00

Or a total of.....\$ 550,000.00
Trans., p. 825.

Complainant, therefore, excepts to the report of the Master in not including any of these items in his estimate of the value of the property.

Summary.

Complainant insists upon a valuation of its plant, excluding toll lines and real estate, as of March 6, 1909, of.....	\$1,702,391.68
Real estate and improvements	162,191.42
Total.....	\$1,864,583.10

The foregoing figures do *not* include franchise, going business, interest, working capital and supplies.

That all of these items are proper to be included in the valuation of the plant is apparent, but Complainant is content with the values above set out, and allows all these omitted items to offset deterioration in the plant, or any lessening of its value below that of a newly constructed plant.

Therefore, Complainant insists that the Master is in error, and should have reported the present value of Complainant's plant and property in the City of Louisville, as of March 6, 1909, and the date of filing his report to be:

Exchange plant.....	\$1,702,391.68
Real Estate	162,191.42
Total	\$1,864,583.10

THE MASTER'S REPORT.

III.

"The gross earnings and the net earnings of the Complainant upon its plant and property employed in its business in said City for the years 1905, 1906, 1907 and 1908, stating separately as to each of said years, and giving the percentage of net income in each year, and whether said percentage is inclusive or exclusive of any allowance for depreciation of property and plant or claims for damages for personal or other injuries."

OPERATING EXPENSES OF THE COMPLAINANT IN CONDUCTING ITS BUSINESS IN THE CITY OF LOUISVILLE DURING 1905, 1906, 1907 AND 1908, ACCORDING TO COMPLAINANT'S BOOKS.

	1905	1906	1907	1908
1. GENERAL EXPENSES (pro rated).....	\$11,205.34	\$11,270.15	\$11,226.76	\$ 9,531.29
2. GENERAL EXPENSES (direct).....	29,271.49	35,948.37	34,826.91	32,545.46
Total.....	\$40,476.83	\$47,218.52	\$46,053.67	\$42,076.75
3. OPERATING EXPENSES.....	84,264.54	80,738.06	79,661.04	75,440.28
4. MAINTENANCE.....	49,819.14	52,796.93	65,616.31	54,705.91
5. RECONSTRUCTION.....	41,051.02	40,626.07	41,895.10	31,450.07
6. INSTRUMENT EXPENSE.....	11,559.76	12,518.70	13,372.49	13,722.52

TOTAL OPERATING EXPENSES.

Year 1905.....	\$227,171.29			
Year 1906.....	\$233,898.28			
Year 1907.....		\$246,598.61		
Year 1908.....			\$217,395.53	

The classified gross earnings of Complainant for the years 1905 to 1908, both inclusive, as they appear on its books, are as follows:

	1905	1906	1907	1908
1. EXCHANGE SERVICE.....	\$264,675.13	\$280,076.12	\$297,501.14	\$307,431.55
2. PROPORTION OF TOLL EARNINGS.....	6,539.92	7,064.91	8,030.15	7,632.11
3. FROM TELEGRAPH COMPANIES.....	983.88	1,018.12	939.48	761.79
4. FROM AMERICAN TELEGRAPH & TELEPHONE COMPANY.....	2,865.29	3,427.09	3,864.17	3,272.37
5. PRIVATE LINE RENTALS.....	1,342.01	1,079.92	1,153.91
6. POLE SERVICE AND ATTACHMENTS.....	953.11	1,096.28	1,177.75	1,229.99
7. LIST ADVERTISEMENTS.....	751.83	2,497.25	2,984.22	3,151.59
8. TELEGRAPH DROPS.....	215.49	976.40	2,110.61	2,130.55
9. MESSENGER FEES.....	862.02	812.40	769.15	658.30
10. REMOVALS AND MISCELLANEOUS.....	1,001.12	680.53	3,278.70	2,682.97
GROSS TOTAL.....	\$280,189.80	\$298,729.02	\$321,809.28	\$328,951.52
Deduct bad debts.....	10,366.42	4,230.58	2,050.77	3,113.22

TOTAL GROSS EARNINGS OF COMPLAINANT AS PLACED TO THE
CREDIT OF LOUISVILLE EXCHANGE.

Year 1905	\$269,823.38	
Year 1906	\$294,498.44	
Year 1907	\$319,758.51	
Year 1908		\$325,838.30

In 1908 "Private Rentals were reported from the Exchange and included in \$307,431.85 'Exchange Service'."

In the above list of classified gross earnings of Complainant the first item which was called to my attention is No. 2, "Proportion of Toll Earnings." There is in the record much evidence which was directed to the Toll Line operations of Complainant Company in the City of Louisville. The object of this testimony was to determine whether or not the Louisville Exchange receives its proper proportion of the Toll Earnings which originated in Louisville. The amount of such earnings which is allotted to the Louisville Exchange is fifteen per cent of the total of outgoing messages. The salaries of toll line clerks and operators, as well as wages of those engaged in the maintenance and repair of toll lines, are charged to Expense Account and Construction Account, respectively, of the Louisville Exchange.

Trans., p. 404.

The Exchange in Louisville is operated as a whole, and the toll lines are embraced in the operation. There are no pole lines leading out of Louisville which carry toll lines exclusively. (Trans., p. 456.) Hence it is that the maintenance and repairs of all pole lines leading out of Louisville, whether such lines carry toll lines or not, are charged to the Louisville Exchange. It appears further that the equipment of the Toll Department, such as switchboards and toll trunks, have been charged to Construction Account of the Louisville Exchange.

Trans., pp. 328, 331 and 333.

The last items mentioned, equipment of Toll Lines Department, are probably included in the total cost of toll lines of the Ohio Valley Company as reported by the accountants. This amount was a little more than \$125,000.00. But be that as it may, the evidence shows that the salaries of employes who perform duties in the Toll Department, as well as the wages and salaries of laborers and others who are engaged in maintaining and reconstructing the toll lines, which bear

toll wires in connection with exchange wires, are all charged to and paid by the Louisville Exchange.

In accordance with what is alleged to be a general custom among telephone companies which operate toll lines in connection with an exchange, the Complainant allots to the Louisville Exchange fifteen per cent of the toll revenues which originate in the City of Louisville, and pays over the remaining eighty-five per cent to the general company for its general purposes. I have been very much perplexed by this state of affairs, as disclosed in the evidence. Custom of trade among merchants has generally received the sanction of the courts. The reason of this is obvious, because merchants trade with each other at arm's length, and what is generally done under such circumstances ought to be and is generally upheld by the courts. But the custom here testified to is a very different thing from the custom of merchants. The parent company manages and controls its subsidiary departments as it deems best. The subsidiary department occupies no position of independence, and, in fact, does not and can not raise a protest. And when it appears, as in this record, that the Louisville Exchange is required to pay all, or nearly all, of the operating expenses of the Toll Line Department and in return is given compensation that is utterly insufficient to pay the expenses it is required to pay, such a custom does not and ought not to appeal to the judicial mind.

Mr. Caldwell and Mr. Smith emphasize the fact that the toll line connections are arranged for the convenience of the subscribers, so that at a moment's notice any subscriber in Louisville may connect with the Long Distance Department, and that this accessibility is an important factor in determining what are reasonable or unreasonable rates to be charged the subscribers.

This argument would be plausible if the Toll Service and its conveniences were furnished by a stranger company, in which case the fair and reasonable distribution of the revenues and the proper allotment of the cost of operation would be regulated and controlled by a solemn contract between independent parties. But Complainant is the owner of the toll lines. It operates them and is entitled to receive and does receive the revenue. It is also the owner of the

Louisville Exchange. The question then is whether or not the division of toll line revenues, as set out above, is fair and reasonable under existing conditions.

The Toll Department and all its apparatus and employes are located in the Main Exchange Building of Complainant. No part of the rent nor taxes nor insurance on this building, nor any part of the insurance on the toll switchboards and equipment are charged to the Toll Department, but all of same are charged to and paid by the Louisville Exchange out of its earnings. The salaries of toll clerks and messengers are also paid by the Exchange. Nor is any part of the salaries of the Private Branch Exchange Operators paid by the Toll Department, but these also are all charged to the Exchange.

It is shown by Mr. Warren (Trans., p. 1089) that a claim for personal injuries, amounting to \$1,500.00, was paid in 1905 to a toll operator who was injured while engaged in the Toll Department, and that this amount was charged to and paid by the Louisville Exchange.

I find that for the years 1905, 1906, 1907 and 1908 the Louisville Exchange has been charged with and paid out as salaries for toll operators, toll chief and telegraph operators, toll clerks and messengers, the following amounts:

1905.....	\$	11,661.80
1906.....		13,616.89
1907.....		13,126.97
1908.....		9,680.10

For the same years the fifteen per cent of the earnings of the Toll Department has been credited or paid to the Louisville Exchange as follows:

1905.....	\$	6,539.92
1906.....		7,064.91
1907.....		8,030.15
1908.....		7,632.11

These items standing alone show a large loss to the Louisville Exchange by reason of the Toll Department. In addition to the above, I find that the Complainant charges up against the Louisville Exchange the rent of all its exchanges, and in addition thereto requires the Exchange to pay the taxes and insurance and repairs on said structures.

It is vigorously insisted by the City, and with much plausibility, that the Toll Department should be charged with its proportion of the general expenses of the Exchange, with printing, stationery, with legal expenses, with advertising, incidentals (operating), traveling expenses and incidentals (repairs), but in view of my findings as to the Toll Department, I will not disturb the last named accounts.

There is another branch of this question that requires notice. It appears that the maintenance repairs and maintenance reconstruction of toll lines and the toll equipment are paid by the Louisville Exchange. What the cost of the labor and materials for these purposes amounts to, I have been unable to ascertain from the record. That it is a substantial sum may be assumed.

The mode of conducting a great business like the one I am considering ought not to be lightly or inconsiderately interfered with, but as to the matters now under consideration, the evidence is of such a character that one is forced to the conclusion that the toll line revenues ought not to be segregated from the exchange revenues.

If the toll business ought to be treated as claimed by Complainant, that is, as a separate and distinct department of Complainant's business, then in fairness it ought to be required to pay all the expenses of its operation, and the Exchange ought to be fairly compensated for its services in aid of the toll line business; but very nearly the entire burden of conducting the toll business has been imposed on the Exchange.

The proper relation of the Toll Department to the Louisville Exchange is a most important factor in determining the revenue belonging to the Exchange, as well as arriving at the proper cost of operating the Exchange. The officers of Complainant, and their witness, Wil-

kinson, in their testimony, have assumed the correctness of the methods of conducting the toll business as above outlined. From what has been said, it is obvious that the Exchange in Louisville would be more remunerative if the Toll Department were not in existence, unless there be merit in the contention that the existence of the toll lines has a direct tendency to attract and increase the number of subscribers. I am not disposed to attach importance to this last suggestion.

It is further true that the Toll Department could not be as profitably conducted, unless it were intimately connected as it is with an exchange. The Complainant owns and controls both departments. Complainant has introduced testimony which shows that the Toll Department, as it is operated, is very profitable, while the Exchange is unremunerative. This condition, as appears from the evidence, is brought about, as I have shown, by the arbitrary allotment of all operating expenses of the Toll Department to the Exchange, and by setting aside only fifteen per cent of its revenue to the Exchange, and by passing eighty-five per cent thereof to the general surplus or reserve fund of Complainant.

While there are some employees of Complainant whose duties are confined to the Toll Department in Louisville, there are many others whose duties are divided between the exchange operations and those of the Toll Department. As already stated, the two departments are located in the same building, and the business of each is intimately and almost inseparably connected with that of the other.

The Exchange is required to pay the total rent of the main building in Louisville where the Toll Department has its headquarters; and, in addition, is required to pay the taxes and insurance and incidental expenses of maintaining the building. I do not find any fault with the requirement that the Exchange should be charged with a fair rental of the various exchange buildings. The evidence shows that the Louisville Exchanges during the years 1905, 1906, 1907 and 1908 were required to pay an average of 8.0675 per cent of the book value of the main exchange as rent. This rent, while somewhat in excess of what similar real estate ordinarily pays in Louisville, might not be deemed exorbitant. But in addition to the above, Complainant

requires the exchange to bear all the cost of taxes, insurance and maintenance. The rent, taxes and insurance charged to the Exchange aggregate an amount equal to 9.91 per cent of the book value of the real estate for each of the four years named.

If the rent and taxes were paid by Complainant out of its general fund, the average rent on the book value of the main exchange would be 6.227 per cent, which is slightly in excess of the customary rental values in Louisville for the years named.

Under the system of management of its properties in Louisville, Complainant treats the Toll Department as an independent entity, separate from the Exchange. It also treats its real estate in Louisville (all of which is a necessary adjunct) as a separate and independent department. The practical result of this system or method is that the net revenue arising from the operations of the Toll Department, the Exchange and the Real Estate Department, amounts in the aggregate to a considerable sum and is most profitable and remunerative to Complainant.

It appears from Complainant's books that under the existing methods, while the Toll Department and Real Estate Department yield a handsome net revenue, the Exchange in Louisville is not earning a fair annual return on the cost of the plant.

It is clearly inequitable that the Exchange be charged with the taxes or the insurance on the buildings of Complainant; and it is equally clear that the Exchange should not be charged with the cost of operating and conducting the Toll Department.

There is evidence in the record which tends to show that the cost of operating the Toll Department and the taxes and insurance on the buildings belonging to Complainant, ought to be shared by the Toll Department and the Exchange in proportion to the revenue received by each, and this percentage is figured out to be 16 1-4 per cent to be paid by the Toll Department and the remainder by the Exchange. But I am not disposed to accept this tentative solution of the problem.

The Toll Department, which handles long distance messages, is

so intimately connected with the Exchange and its operations that it is difficult to segregate them; the operators are largely engaged in handling both local and long distance business; the pole lines leading out of the Exchange carry both toll lines and exchange lines; the maintenance of these pole lines is borne by the Exchange, and nearly all of the cost of operating the toll business is borne by the Exchange; the Toll Department occupies a part of the Main Exchange Building, yet it pays no rent nor insurance nor taxes nor cost of repairs or maintenance. In addition, Mr. Smith, the Auditor of Complainant (Trans., pp. 328 and 331), frankly states that the cost of construction or reconstruction of the toll switchboard was paid for by the Exchange and charged to Construction Account of Exchange.

I fail to see any just reason for separating the earnings of the Toll Department from the earnings of the Exchange. If all the toll earnings be given to the Exchange and the expense of toll operations and the taxes and insurance be paid out of Exchange earnings, the result will not affect the net cash receipts of Complainant.

I have given this matter much thought and consideration, and I am satisfied that the arbitrary division of the toll revenues at Louisville between the Complainant and the Exchange under all the existing conditions above enumerated, is unjust and inequitable and should not be approved.

It is, perhaps, not unnatural in this controversy that Complainant should, by all plausible means, undertake to increase its Expense Account and decrease its Revenue Account. This effort on its part involves no moral problem, but is purely and simply a question of business propriety. It is more strictly a matter of book-keeping.

Therefore, if the various expense items above enumerated growing out of the Toll business are allowed to stand, as they appear on the books of Complainant, as charges against the Exchange, the Exchange in return should be credited with the net toll revenues for the four years of 1905, 1906, 1907 and 1908.

The Joint Report of the accountants shows that, according to the books of the Complainant, the total gross earnings of Complainant, as placed to the credit of the Louisville Exchange, were as follows:

1905.....	\$ 269,823.38
1906.....	294,498.44
1907.....	319,758.51
1908.....	325,838.30

The above amounts include fifteen per cent of the toll earnings which are set out supra. In their separate reports, the accountants differ as to the net toll receipts at Louisville for each of the years under consideration. I have attempted to reconcile these differences, but the effort has been unsatisfactory, chiefly because the accountants have pursued different methods of analysis. For instance, the city's accountants have considered and embraced the incoming toll messages as well as the outgoing, and have surcharged the accounts in a few instances, and thus they show that the Toll Department's receipts were greater each year than appear on Complainant's books.

The accountant for Complainant accepts the Complainant's books as correct. In order to avoid sundry technicalities, I give Complainant the benefit of the doubt, and I have accepted these accounts as they appear on its books.

The net Toll receipts, *after deducting fifteen per cent*, which were credited to the Exchange on Complainant's books, were as follows:

1905.....	\$ 37,059.53
1906.....	40,034.58
1907.....	45,504.16
1908.....	43,248.70

With these amounts added to the total gross earnings of Complainant, as shown above, it appears that the total gross earnings were as follows:

1905.....	\$ 306,882.91
1906.....	334,533.02
1907.....	365,262.67
1908.....	369,087.00

Having ascertained the gross earnings of Complainant in Louisville, it becomes necessary to determine the amount of Operating Expenses, in order to ascertain the net earnings, and thus establish the percentage of such earnings for the years 1905, 1906, 1907, 1908.

The Joint Report shows that the Operating Expenses for each year, according to the books of Complainant, were classified as follows:

- First: General Expenses (prorated).
- Second: General Expenses (direct).
- Third: Operating Expenses.
- Fourth: Maintenance.
- Fifth: Reconstruction.

General Expenses consist of the pro rata proportion of Executive Management Expenses at Complainant's principal office at Nashville, which include general officers' salaries and those of their assistants, and salaries and wages of clerical force, rent, light and heat at principal offices, traveling expenses of officers and incidental expenses.

The Joint Report shows the amount of such prorated general expense for each year as they appear on Complainant's books, as follows:

1905	\$ 11,205.34
1906.....	11,270.15
1907	11,226.76
1908	9,531.29

The accountants employed by the city find fault with these totals and insist that some of the items which are embraced in the totals of General Expenses—prorated—should have been charged

to the Toll Department; and that some of them should be charged to the Supply Department, and some to Expense of Real Estate.

As to the objection first stated, my conclusion as to the proper disposition of the Toll earnings, logically places the expenses of that Department as a proper charge against the Exchange earnings.

Those items which are claimed to be chargeable to the Supply Department amount, on an average, to \$830.45 for each of the four years above named. There is much reason for criticizing the operations of the Supply Department, as has been shown heretofore in this Report. But as the elucidation of this alleged error is difficult, and by no means satisfactory, and as the amount in dispute is not large, I have not felt justified in sustaining the point raised.

I find, therefore, the item "Prorate of General Office Expenses" correct, as stated supra.

The next item of General Expenses—direct—and pro rata of General Account, which includes postage, printing and stationery, directory expenses, taxes and legal expenses as claimed by Complainant, amount to the following:

1905.....	\$	29,271.49
1906.....		35,948.37
1907.....		34,826.91
1908.....		32,545.46

For reasons already assigned, I find that the taxes charged to the Exchange for the years 1905, 1906, 1907 and 1908 should be disallowed. The rent charged to the Exchange is, under the evidence, at a reasonable and customary rate; but if, in addition thereto, the taxes and insurance are added, the charge against the Exchange becomes excessive. I speak now of the Main Exchange only. I do not make any change in the accounts relative to the other three exchanges.

The taxes which I find should be deducted from the General Expense Account are as follows:

1905.....	\$ 1,118.97
1906.....	1,059.91
1907.....	1,077.72
1908.....	1,032.15

Thus I find the General Expenses of the Louisville Exchange for the four years were as follows:

1905.....	\$ 29,271.49	
		1,118.97
	\$ 28,152.52	
1906.....	\$ 35,948.37	
		1,059.91
	\$ 34,888.46	
1907.....	\$ 34,826.91	
		1,077.72
	\$ 33,749.19	
1908.....	\$ 32,545.46	
		1,032.46
	\$ 31,513.00	

The accountants in the case agree as to the total of the next item, to-wit, Operating Expenses, but they differ as to its proper distribution.

The totals of this item for the four years are as follows:

1905.....	\$ 84,264.54
1906.....	80,738.06
1907.....	79,661.04
1908.....	75,449.28

The city insists that the Toll Department should be charged with its proportion of these totals, to-wit:

1905.....	\$	16,517.88
1906.....		18,247.44
1907.....		17,660.18
1908.....		14,533.13
Total		\$ 66,960.63

These charges against the Exchange should clearly be made against the Toll Department, if the latter be treated as an independent department, as I have shown *supra*. But, as I have already disposed of this question, it is unnecessary to go critically into an investigation of the correctness of these figures.

In regular order, the next items of expense are Maintenance Repairs. "The charges under this heading are for the current repairs, mending breaks, tightening wires, rectifying 'trouble,' and generally maintaining the property in first-class running order." (Trans., p. 783). "These expenses include salaries and wages of foremen, linemen, electricians and troublemen, materials for repairs of plant, and for replacement of parts which wear out in less than a year; traveling expenses and keep of teams, repairs to wagons and vehicles, coal, conduit and roof rent, fire insurance on plant, payments for damages to persons and property and miscellaneous expenses incident to maintaining the telephone plant in good working condition."

The accountants for Complainant and Defendant respectively, differ as to what should be a proper distribution of these maintenance expenses. For instance, a certain proportion of the traveling expenses of the officers and employees; a certain proportion of the insurance on the Main Exchange, and a personal injury compromise claim, and a certain proportion of incidentals, it is insisted, should be charged to the Toll Department.

These items, for the four years stated, amount in the aggregate, as follows:

1905.....	\$	2,267.95
1906.....		867.13
1907.....		1,148.36
1908.....		630.44
Total.....		\$ 4,913.88

But, for reasons stated *supra*, these items must stand, as the revenue from the Toll Department is credited to the Exchange.

The other objections I disallow, so that the maintenance for the four years must stand as follows:

1905	\$ 49,819.14
1906	52,796.93
1907	65,616.31
1908	54,705.91

The next item of expense to be considered is entitled Maintenance Reconstruction. This is a subdivision of Maintenance. (Trans., p. 815.) The items making up this account are mainly salaries and wages, materials and traveling expenses. Why this separate account should have been kept I cannot understand from the evidence. The witnesses on behalf of Complainant admit that the two accounts, Maintenance and Maintenance Reconstruction, are practically one and the same. Mr. Caldwell says the distinction between them is shadowy. Indeed, prior to 1905, no separate Reconstruction Account was kept by Complainant. From 1905 to 1907, inclusive, such an account was kept, but in 1908 was again discontinued and was merged into the Maintenance Account.

The amount of this account, Maintenance Reconstruction, for the four years is as follows:

1905	\$ 41,051.02
1906	40,626.07
1907	41,895.10
1908	31,450.07

The account for 1908 is estimated.

I see no reason to disallow these items.

The next item, "Instrument Expense," seems to be agreed to by both accountants, and this amounts to the following:

1905.....	\$ 11,559.76
1906.....	12,518.70
1907.....	13,372.49
1908.....	13,722.52

I therefore find that the total Operating Expenses of Complainant for the four years, including the accounts last above considered, were as follows:

1905.....	\$ 226,052.32
1906.....	232,838.37
1907.....	245,520.89
1908.....	216,363.07

If the operating expenses of Complainant be deducted from the gross revenues as I have found them, the net income for each year will be found as follows:

1905.	Gross revenues.....	\$ 306,882.91
	Operating Expenses.....	226,052.32
	Net Income.....	\$ 80,830.59
1906.	Gross revenues.....	\$ 334,533.02
	Operating Expenses.....	232,838.37
	Net income.....	\$ 101,694.65
1907.	Gross revenues.....	\$ 365,262.67
	Operating expenses.....	245,520.89
	Net income.....	\$ 119,741.78
1908.	Gross revenues.....	\$ 369,087.00
	Operating expenses.....	216,363.07
	Net income.....	\$ 152,723.93

On page 46 of this Report, I have placed the value of Complainant's plant, as of March 6, 1909, including toll lines, after deducting ten per cent as a proper allowance for depreciation, at.....\$1,355,878.09
This does not include real estate nor working capital.

In order to ascertain the percentage of the net earnings for each of the four years, it is necessary to ascertain what the value of Complainant's plant was at the end of each year from 1905 to 1908, inclusive.

It appears from the Joint Report (Trans., p. 742), that the total amount expended for Construction Account of the plant, stated by years, was as follows, according to Complainant's books:

1905.....	\$ 60,691.21
1906.....	89,125.15
1907.....	20,770.42
1908, taken out.....	4,351.83

At the end of each of the years last named, the value of Complainant's plant, including Toll Department was:

1905.....	\$1,355,878.09
Deduct Construction Account for 1906 and 1907.....	109,895.57
Value of plant at the end of 1905.....	\$1,245,982.52
1906.....	1,355,878.09
Deducting amount expended in 1907 for Construction.....	20,770.42
Value of plant at the end of 1906.....	\$1,335,107.67
1907, Value of plant at the end of year.....	1,355,878.09
1908.....	1,355,878.09
Amount of error in Construction Account taken out.....	4,351.83
Value of plant at end of 1908.....	\$1,351,526.26

I have found, in answer to Interrogatory No. 5 (see pp. 144-5), that a proper allowance for depreciation will be seven per cent of the value of the plant for each of the years 1905, 1906, 1907 and for 1908, and for subsequent years.

In order, therefore, to make my finding as to the net profit and the percentages thereof, I must show under this division the amount of such depreciation found and how it will affect the net earnings.

The value of the plant has been found supra as of the years 1905, 1906, 1907 and 1908, and the seven per cent depreciation allowed for each of said years is found as follows:

1905	\$86,818.77
1906	93,457.53
1907	94,914.66
1908	94,606.83

The amount of depreciation allowed for the four years gives an annual average of\$92,449.45

The amount actually expended by Complainant for Maintenance and Reconstruction for each of said years is as follows:

1905	\$ 90,870.36
1906	93,423.00
1907	107,511.41
1908	86,155.98

These amounts show an annual average outlay for Maintenance and Reconstruction of\$ 94,490.19

The average annual excess of expenditures over allowance for depreciation is 2,050.74

An analysis of the above figures leads me to believe that in a period of ten or fifteen years the allowance of seven per cent for depreciation will be ample. An expenditure for maintenance in one year of an amount in excess of seven per cent will probably be followed in the next year by a requirement of a less amount.

But in ascertaining the percentage of Net Earnings to the value of the plant, it is proper to deduct from the Net Earnings as found above, the average excess of the Maintenance Expense over the average allowance for depreciation.

The Net Earnings were as follows:

1905.....	\$ 80,830.59
Deduct excess of expenditures as above.....	2,050.74
Leaving Net Earnings.....	\$ 78,779.85
1906, Net Earnings.....	101,694.65
Deduct excess of expenditures over depreciation.....	2,050.74
Leaves Net Earnings.....	\$ 99,643.91
1907, Net Earnings.....	119,741.78
Deduct excess of expenditures over depreciation allowance.....	2,050.74
Net earnings.....	\$ 117,691.04
1908, Net Earnings.....	152,723.93
Deduct excess of expenditures over depreciation allowance.....	2,050.74
Net Earnings.....	\$ 150,673.19

The percentage of Net Earnings to the value of Complainant's plant, for the four years, was as follows:

1905.....	6.32 per cent
1906.....	7.46 per cent
1907.....	8.68 per cent
1908.....	11.14 per cent

The above percentages are inclusive of allowance for depreciation of property and plant and claims for damages for personal or other injuries.

EXCEPTIONS OF APPELLEE.

"A"

The Master reports Complainant's gross earnings as set out in his report.

The Master states (*supra* pp. 72 and 73), what he says are the classified gross earnings of Complainant for the years 1905 to 1908, as found by the accountants:

1905.....	\$ 269,823.38,
1906.....	294,498.44
1907.....	319,758.51
1908.....	325,838.30

This includes all exchange earnings, 15 per cent on tolls, toll earnings from American Telephone & Telegraph Company, private line rentals, pole service and attachments, list advertisements, telegraph drops, messenger fees, removals and miscellaneous.

"B"

The Master refusing to accept the joint report of the accountants as to what the gross earnings really were for the respective years has undertaken to rearrange the earnings upon a basis of his own, which is not reported by any of the accountants, nor testified to by any of the witnesses, and the first of these items to be noticed is:

Complainant excepts to the report of the Master (supra p. 73), in which he declines to allow 15 per cent of the toll earnings to be credited to the exchange as a proper allowance to the exchange for the service performed by it in handling the toll business.

The records show, without controversy, that Complainant owns and operates a system of exchanges and toll lines throughout a territory one thousand miles long and four hundred miles wide.

Trans., p. 209.

At these five hundred and seventeen exchanges, exchange service is given to local subscribers, and toll or long distance service is given through the exchange to these local subscribers and to the public generally, for a compensation graduated according to distance and the time of the conversation.

It is shown in the record without dispute that the construction of toll lines and exchanges, and receipts from exchanges and toll lines can be and are kept separate and distinct, but that it is impossible to

separate the operating expenses of the exchange from the operating expenses of the toll lines.

Trans., p. 509.

Trans., p. 677.

Trans., p. 459.

It is stated by two of Defendant's witnesses that this separation of expense can be done. One of them, Mr. Polk, gives no way in which it can be done.

Trans., p. 1508.

Mr. Crumb in his deposition, after stating it can be done, when asked to explain how, shows conclusively that it is impossible.

Trans., p. 898.

The record shows that it is the universal custom among telephone companies throughout the system to contract with each other for this service, and fifteen per cent is the maximum amount allowed the exchange for handling the toll business.

Trans., pp. 466, 509 and 677.

It also appears that in more than a hundred cases Complainant has contracts, some of which provide that Complainant shall at some of its exchanges handle the toll business of other companies for a compensation of fifteen per cent of the out-going toll messages, and that many other companies handle Complainant's toll business through their exchanges for the same compensation.

Trans., p. 466.

There is no evidence in the record to the contrary, and no instance is cited in which a higher compensation has ever been allowed to an exchange by a long distance company for performing this service.

The Master (p. 74), states:

"Custom of trade among merchants has generally received the sanction of the courts. The reason of this is obvious, because merchants trade with each other at arms' length, and what is generally done under such circumstances ought to be, and is generally upheld by the courts, but the custom here

testified to is a very different thing from the custom of merchants. The parent company manages and controls its subsidiary departments as it deems best. The subsidiary department occupies no position of independence, and, in fact, does not and cannot raise a protest."

The Master overlooks the entire testimony with respect to other companies dealing with Complainant on this basis, and Complainant dealing with other companies on this basis. The Master assumes, through inadvertance, no doubt, that the only contracts referred to in the record are contracts between Complainant dealing with itself, with respect to its toll and exchange departments.

This, however, is not a fact. Complainant, of course, makes no contract between its toll and exchange departments. It operates its entire system of exchanges and toll lines as one property; it carries in its general books the construction, receipts and disbursements of each of its five hundred and seventeen exchanges, and its system of toll lines; but for the purpose of ascertaining the earnings of each exchange, and the earnings of the toll lines, it becomes necessary for Complainant to separate the exchange earnings and the toll line earnings, both gross and net. There is no difficulty in separating its gross earnings. That is kept separate and distinct, but when it becomes necessary to separate the expenses between the exchange and the toll lines entering that exchange, the problem is most difficult. It has been attempted to separate accurately the expense of doing both kinds of business at the same place, but it has been found to be impossible.

Trans., p. 510.

Therefore, in order to ascertain the net earnings of an exchange, it must separate on its own books the earnings and expenses of the two kinds of business on precisely the same basis that it is willing to and does contract with other companies, and the basis upon which other companies are willing to and do contract with Complainant. It is for this reason that evidence has been introduced to show the universal custom of telephone companies dealing with each other at arms' length, independent, and each seeking every proper and just advantage.

These companies deal with each other on the basis of the owner

of the toll lines paying to the owner of the exchange fifteen per cent of the out-going messages as compensation for the exchange service in handling the toll business, including necessary central office equipment, rent, operating services, accounting and collecting; and the owners of the exchanges are willing to and do handle the toll business of the long distance companies for a compensation of fifteen per cent of the toll earnings originating at their exchange.

It is also to be noted that no one in this record criticises this basis except the Mutual Audit Company. Neither Mr. Polk, Mr. Levings nor Mr. Crumb criticises this compensation to the exchanges by the toll lines.

On p. 779 of Trans., Wilkinson states:

"RATE OF CONNECTING COMPANIES."

"We find that the Complainant does business with a great many other telephone companies, whose toll lines connect with the Complainant's exchanges, at various points throughout the State of Kentucky, *excepting* Louisville,

19 companies or individuals receive from the Complainant a commission of 15% (or less) on originated messages.

14 companies or individuals agree to interchange services without charge.

2 companies receive 15% with a small added charge for extra facilities furnished.

35 in all.

We submit for your consideration the suggestion that the foregoing facts establish that the 15% commission allowed to the Louisville exchange for the terminal facilities and recording furnished, is a sufficient remuneration for the service rendered.

In this connection, it is proper to bear in mind that the plant and property owned by the Complainant in the City of Louisville, includes the switchboard and other exchange equipment used in affording terminal facilities for long distance traffic."

The separate report of the Mutual Audit Company was prepared by Mr. Farnham, its General Manager, and Mr. Warren, one of its employees.

Trans., p. 1116.

Neither of these witnesses have ever had any experience in the telephone business. Mr. Farnham is not even an expert accountant. He has been a locomotive engineer, a telegraph operator, a train dispatcher, engaged in construction work, electrician, detective, express business, and general manager of some railroad companies, but has never been either a telephone man or an expert accountant.

Trans., p. 703.

Mr. Warren testifies that he never before examined telephone accounts, and has been a bookkeeper throughout his career, being only thirty-two years of age.

Trans., pp. 1026 and 1113.

So far as this record shows, fifteen per cent commission to the exchange for operating and handling of long distance calls from the toll lines *is* the *correct* and *proper* compensation for the service rendered.

It is also shown, and not in any way disputed, that it is an added value to the exchange subscribers to be able to be put into communication with the toll lines so as to receive, or send, long distance calls from their particular station in their residence or business house, and this advantage and benefit is taken into consideration in fixing the exchange subscribers' rates.

Trans., p. 509.

The Master (Post. 178) says:

"Connection with these long distance lines may be had promptly by subscribers, and this, I consider a most valuable asset, and in my opinion, it will in the future, as in the past, materially aid Complainant in its efforts to secure new subscribers."

If Complainant owned no toll lines, it would, as the Master states, be willing and anxious to make a contract with a long distance company to connect with it and handle its toll business, in order that its subscribers might have this added facility, and would, in fixing subscribers' rates, take into consideration this added advantage, which had been contracted for with the long distance company.

The Master (*supra* p. 74) states:

"Mr. Caldwell and Mr. Smith emphasize the fact that the toll line connections are arranged for the convenience of the subscribers, so that at a moment's notice any subscriber in Louisville may connect with the Long Distance Department, and that this accessibility is an important factor in determining what are reasonable or unreasonable rates to be charged the subscribers.

This argument would be plausible if the toll service and its convenience were furnished by a stranger company, in which case the fair and reasonable distribution of the revenues and the proper allotment of the cost of operation would be regulated and controlled by a solemn contract between independent parties. But Complainant is the owner of the toll lines. It operates them and is entitled to receive, and does receive the revenue. It is also the owner of the Louisville exchange. The question then is whether or not the division of toll line revenues, as set out above, is fair and reasonable under existing conditions."

The Master, stating that fifteen per cent of the out-going tolls does not appeal to him as being a reasonable division, proceeds to allot to the exchange *one hundred per cent* of the tolls, thus taking the entire revenue of the toll lines and treating it as a part of the exchange revenue.

It is submitted that if fifteen per cent is not sufficient compensation to the exchange, one hundred per cent is certainly too much compensation.

The Master, no doubt, was influenced in his conclusion by assuming that the fifteen per cent commission was largely less than it really is.

He states (*supra* p. 75) that the fifteen per cent of the earnings of the toll department has been credited or paid to the Louisville Exchange as follows:

1905	\$	6,539.92
1906		7,064.91
1907		8,030.15
1908		7,632.11

The correct amount is:

1905.....	\$ 10,482.72
1906.....	12,280.80
1907.....	14,774.08
1908.....	13,693.33

See p. 72, where the proportion of tolls earned includes items 2, 4, 8 and 9, making the totals above set out.

For the foregoing reasons, Complainant excepts to the report of the Master in declining to accept fifteen per cent of the toll earnings as a proper compensation to the exchange for handling the toll business for the long distance lines.

"C"

Complainant excepts to that part of the report of the Master in which he states that the exchange plant is charged with the expense of maintenance and reconstruction of toll lines.

The Master states (*supra* p. 76):

"There is another branch of this question that requires notice. It appears that the maintenance, repairs and maintenance--reconstruction of toll lines and toll equipment are paid by the Louisville exchange. What the cost of the labor and material for this purpose amounts to I have been unable to ascertain from the record. That it is a substantial sum may be assumed."

It is not shown anywhere in the record that the cost of maintaining and reconstructing toll lines is charged to the Louisville Exchange. In this the Master is in error. The most that can possibly be claimed is that where a break or accident happens to a pole route in the Louisville Exchange plant which carries toll lines as well as exchange subscribers' lines, that the employe of the company who repairs the break in the subscribers' lines also repairs the break in toll wires. It is only such small items as this,

if any, that can be shown to have been charged to the Louisville Exchange.

But even though the entire toll lines inside the Louisville Exchange area were maintained and reconstructed and charged to the Louisville Exchange, the amount would be too insignificant to affect any result or call for special attention and treatment.

It is shown in the record that there are only eighty toll circuits entering the Louisville Exchange, and a part of these are used to give free service to the exchange subscribers of the Louisville plant to the various small exchanges in metropolitan Louisville.

Trans., pp. 226 and 457.

It is also shown that every toll circuit entering Louisville comes in on exchange subscribers' pole routes.

Trans., p. 456.

These pole routes would have to be maintained whether they carry toll circuits on them or not, and the proportionate amount of the maintenance to be apportioned to toll circuits in comparison with exchange subscribers' circuits is shown as follows:

The proportion of circuits to the number of telephones installed in the Louisville Exchange is sixty-two per cent.

Trans., p. 632.

The number of telephones in use in the exchange is 9,395.

Trans., p. 624.

It thus appears that 62 per cent of 9,395 gives 5,824, the number of exchange circuits in use in the exchange. Assuming that the entire eighty toll line circuits were used exclusively for toll line business, and no part of them were used in giving free service to the Louisville subscribers to the small adjoining exchanges, it would result that less than one and one-half per cent of the circuits in the Louisville Exchange are toll circuits. And thus it is that, assuming they are maintained in the Louisville Exchange area, and charged to the Louisville Exchange Expense Account, the amount is so inconsiderable as to be of no practical use or value in this case. One and one-half per

cent of the entire maintenance and reconstruction expense of the Louisville Exchange, covering switchboards, instruments, poles, wires and all apparatus and material of every kind is for 1908, \$1,292.32, but of course the entire amount of maintenance and reconstruction expended in 1908 was not expended on either poles or wires. Even if fifty per cent of the maintenance and reconstruction for 1908 was incurred on account of poles and wires in the Louisville plant, then the amount to be borne by the toll circuits, assuming all of them to have been used exclusively for long distance business, would amount to less than \$646.16.

It is, therefore, submitted that the criticism of the Master in this respect is quite immaterial.

"D"

Complainant excepts to the report of the Master in the method by which he reduces the rent of the real estate and improvements owned by Complainant in Louisville.

It has been the practice of the Complainant to carry upon its books its real estate in a separate account. It added no part of the cost or value of its real estate to the plant account. It required the exchange to pay a revenue of not exceeding eight per cent upon the actual cost, but the buildings on the real estate were maintained out of this not exceeding eight per cent, and the exchange paid the insurance and taxes.

This was done as a convenience to Complainant in keeping its accounts. It is not unfair to its patrons, since Complainant is entitled to a net revenue of at least eight per cent (less the repairs on real estate improvements), as compensation for furnishing the real estate and improvements for the use of the plant. Another reason for this is that Complainant does not charge any depreciation against any part of the real estate and improvements in ascertaining depreciation of the plant, and for this reason it is necessary to keep separate the real estate department from the remainder of the plant; but the criticism of this treatment of the real estate only involves a small amount.

In 1908 the exchange paid as rent for the real estate
and buildings \$ 13,800.00
Trans., p. 786.

Complainant paid out of this sum for repairs on the
buildings 2,092.48
Trans., p. 787.

Making a net rental of \$ 11,707.52
The cost and value of the real estate to December 31,
1908, is 160,841.42

Which gives Complainant a net return on its real
estate in Louisville for 1908 of only 7.28 per cent.

However, if no rent is to be charged against the plant
for the real estate, then the plant value must be increased
by the value of the real estate, and in this way the
amount for 1908 upon which a net return must be earned
is increased by 160,841.42

If Complainant is allowed to earn net only 6 per cent
on the value of its plant, the difference is only 2,056.62

It is thus seen that the Complainant's treatment of
real estate can only increase the expenses of the exchange,
on a basis of a 6 per cent net return 2,056.62

"E"

*Complainant excepts to the following language from the Master's
report; (page 77).*

"It is further true that the toll department could not be as
profitably conducted unless it were intimately connected as it
is with an exchange. The Complainant owns and controls
both departments. Complainant has introduced testimony
which shows that the toll department as it is operated is very
profitable, while the exchange is unremunerative. This con-
dition, as appears from the evidence, is brought about, as I have

shown, by the arbitrary allotment of all operating expenses of the toll department to the exchange, and by setting aside only fifteen per cent of its revenue to the exchange, and by passing eighty-five per cent thereof to the general surplus or reserve fund of Complainant."

The Master is entirely in error in this statement. No proof was introduced showing whether the toll department was remunerative or unremunerative. The toll department was not under inquiry, and no proof was offered by either party to show the result of the operation of the toll lines, nor did the Master request any such proof.

The Master assumes that eighty-five per cent of the toll line receipts are net profits, and are passed to the reserve account of Complainant. Complainant excepts to this statement. Such matters were not gone into in the evidence because there was no inquiry directed to this part of the Complainant's business by the Court in the Order of Reference.

There is no evidence in the record that the toll department could not be as profitably conducted if it were independent of the exchange, and the statement that its intimate connection with the exchange is responsible for its prosperity is a conclusion of the Master without evidence to support it.

"F"

Complainant excepts to that part of the report of the Master (p. 79), where he states.

"I fail to see any just reason for separating the earnings of the toll department from the earnings of the exchange. If all the toll earnings be given to the exchange, and the expenses of toll operations and taxes and insurance be paid out of exchange earnings, the result will not affect the net cash receipts of Complainant."

In this statement the Master again assumes that the only expense connected with the toll department is that performed by the exchanges for which they receive fifteen per cent commission.

This assumption leaves out of view entirely the expense of maintenance, reconstruction and other expenses in connection with the operation of a toll line system. It ignores the many items of expense which of necessity must be incurred in keeping toll lines free from obstructions, keeping insulation in proper condition so that the lines may be used by Complainant's patrons. It leaves out of view the enormous expense of erecting these pole lines throughout the entire area of Complainant's territory, the taxes, damages, various other items of expense in constructing, maintaining and reconstructing the toll line system.

"C."

Complainant excepts to the report of the Master in stating that its books show operating expenses as set out in his report.

The Master sets out (p. 72), what he says are the operating expenses of the Complainant for the years 1905 to 1908 inclusive, "*according to Complainant's books.*"

In this the Master is in error. These are the operating expenses of Complainant as corrected and classified in the joint report of the accountants, *and are not what the books of Complainant show*, but are essentially different.

Trans., p. 745.

The joint report of the accountants shows operating expenses as follows:

1905	\$227,171.20
1906	233,898.28
1907	246,598.61
1908	217,395.53

The books of Complainant show operating expenses as follows:

1905	\$240,263.39
1906	247,130.03
1907	260,126.33
1908	227,495.66

There is a difference between the operating expenses as shown on Complainant's books and the amount reported in the joint report of the accountants as follows:

1905	\$ 13,092.10
1906	13,231.75
1907	13,527.72
1908	10,100.13

A part of the difference in each of these years is accounted for as follows:

Complainant in keeping its books charges up all exchange earnings under the head of "Revenue." This is done because these charges are placed upon its books before it is known whether all these accounts can be collected. Thereafter, when it is ascertained that any accounts are uncollectible, they are charged as expenses, which offsets a like amount of revenue. This is done because it is more convenient in keeping the books to do it this way.

The accountants, in making up their joint report, knowing what revenue had been collected, stated the net revenue that had been collected by Complainant, and, therefore, did not charge uncollectible accounts as an expense. The result to Complainant is the same, and its books at the end of any given period would show larger gross earnings, and larger expenses by the exact amount of uncollectible accounts, but the one would offset the other. The accountants have eliminated bad debts, both from the earnings and expenses, thus leaving earnings and expenses without being encumbered with uncollectible accounts.

So that, as stated, a part of the difference in expenses between the books of Complainant and the joint report of accountants, as above set out, is as follows:

	Bad Debts.	Net Difference.
1905	\$1,679.39	\$11,412.71
1906	1,519.41	11,712.34
1907	2,344.94	11,182.78
1908	3,707.34	6,392.79
Trans., Exhibit attached to p. 474.		

Substantially all the remainder of this difference is accounted for in the following way:

During the time the Mutual Audit Company were examining the books of Complainant they had in their employ at Nashville, Tenn., but *not* in the office of Complainant, where they were engaged in their work, a man by the name of Settle, who had been for many years local cashier of Complainant at its Louisville Exchange. It was developed that he was a defaulter and he was discharged about September, 1908.

Trans., pp. 1005-1006.

This witness occupied a desk in Complainant's office of its Main Exchange Building in Louisville on the first floor. He undertakes to give with great accuracy, during all of the time he was so employed, the exact amount of time various of Complainant's employees spent in the Louisville Exchange, and the time spent by them elsewhere. He undertakes to give the time spent by the Superintendent of the Louisville Division in his office, although the Superintendent's office was on the next floor, and was entered by a door not connected with the floor on which Settle had his desk.

Trans., p. 992 *et seq.*

The Mutual Audit Company, having in its employ this young man Settle, undertook to deduct from the Louisville Expense Accounts a part of the wages and salaries of the men named by Settle in proportion that the time Settle said they were in the Louisville Exchange compared with the time he said they were in other places.

It thus appears that these deductions were made from the expenses as entered upon the books of Complainant, and as shown by the original pay-rolls, *alone* upon the statement of a man who had proven unworthy of confidence, and who had been discharged from Complainant's service.

As soon as these facts were developed in the evidence, proof was introduced by Complainant to show, not only that these deductions from its expenses were unjust, but that it was a physical impossibility for Mr. Settle to have any such knowledge as he claimed to possess,

and upon which deductions of several thousand dollars per annum had been made from the expenses of conducting Complainant's Louisville Exchange.

Mr. Hume, the General Manager of the Company, makes the following explanation:

"The exchange, in addition to being under the general supervision of a district superintendent, has its local manager, its general foreman of plant or construction, its chief electrician, its chief operator, and the employes that work in these respective departments, and what is there is what would be found in the same size exchange, approximately the same size exchanges as at Nashville and Memphis, no more and no less. As to Mr. Settle's charge that there were men there who were giving one-fourth of their time or any other material part of their time to outside matters, he has made the charge without personal knowledge and without fact. The matter that he has gotten on his mind in a twisted manner is simply this, that in the development of the business around what we term the metropolitan district of Louisville, we have put in a number of small switching exchanges in various sections of the country, both in Kentucky and in Indiana, within a radius of twenty or twenty-five miles of the City of Louisville itself, and at each of these small exchanges, we have employes to take care of the exchange and to give the service from the switchboard. In other words, at each of those switchboards, we have exactly the force we would be compelled to have and that would be found in other small exchanges, even though they might be a hundred miles from any large exchange, but, on account of the fact that to all those exchanges and from all those exchanges there are certain subscribers who have arranged for Louisville service, and the further fact that all the subscribers of Louisville are given access to all these special subscribers in all these exchanges referred to, and given this service without any charge whatever in the way of tolls or additional monthly rate in their exchange, in the interest of their exchange, in the interest of the Louisville service, we allow the manager and the other supervising officers of the Louisville Exchange to do whatever may be necessary in the way of supervising, in watching over the service at these smaller exchanges, but whenever it comes to any actual work, the employment of any of our linemen or troublemen or electrical men or plant men or material shipped to Louisville for the use of Louisville, every item and every

minute of time employed by such employees is reported and the proper credit given on the Louisville account and proper charge made against these smaller exchanges that are not in every respect and, in fact, a part and parcel of the Louisville plant."

Trans., pp. 674-675.

Mr. Hume then shows how impossible it is for Mr. Settle to have been able to determine what portion of time any of these employees spent in or outside the Louisville Exchange.

Trans., p. 675.

Notwithstanding these facts, the accountants, who are merely bookkeepers and did not know anything about the reasons actuating Complainant's officers in charging up the expenses of the Louisville Exchange as they did, have seen fit to deduct several thousand dollars each year from the expenses of the exchange which properly belonged thereto.

However, under the agreement heretofore referred to, if Complainant is bound by the joint report of the accountants, then the total expenses for the four years are as follows:

1905	\$ 227,171.29
1906	233,898.28
1907	246,598.61
1908	217,395.53

"H"

Complainant excepts to the report of the Master pp. 82 and 83, where he deducts from the General Expense Account taxes paid on the Main Exchange Building, and charged as an expense against the exchange.

It has heretofore been shown under the head "D" pp. 98 and 99 how real estate is treated by Complainant.

However, the amount deducted by the Master is small and not material in the final result.

"I"

Complainant excepts to the statement of the Master on page 84 in which he states that certain expenses should be deducted as chargeable to toll department in the event the toll department is separated from the exchange.

He says:

"These charges against the exchange should clearly be made against the toll department, if the latter be treated as an independent department, as I have shown supra. But, as I have already disposed of this question, it is unnecessary to go critically into an investigation of the correctness of these figures."

The Master is giving the figures presented by the Mutual Audit Company upon some kind of a theory that the expenses of the toll business and the exchange business should be divided and prorated on the basis of revenue derived from each.

This is purely a theory which has no evidence to support it, and it is manifestly erroneous. It assumes that the toll department is equally as profitable as the exchange department; it leaves out of view any question of what the total toll expenses of conducting the toll department may have been; expenses are then prorated on the basis of toll earnings; it presumes to pro rate expenses on one business because expenses on another business have been ascertained.

However, if these expenses are to be charged against the toll department and taken out of exchange expenses, then the toll receipts should not be credited to the exchange earnings. The result would not be substantially different from that obtained by charging the expenses to the exchange and crediting the exchange with 15 per cent of the toll line earnings, as Complainant has done in its accounts. The difference between the two amounts is not very material.

The total toll expense, as claimed by the Mutual Audit Company is:

1905.....	\$ 23,536.25
1906.....	24,671.90
1907.....	24,478.86
1908.....	20,239.65

Trans., exhibits 9, p. 1357.

The amount added to exchange earnings, by allowing the exchange 15 per cent of toll earnings, is:

1905.....	\$ 10,482.72
1906.....	12,280.80
1907.....	14,674.08
1908.....	13,693.33

Page 72, items 2, 4, 8 and 9.

The difference is all that can be claimed by any one to have been added to exchange expenses above what is admitted by all to have been exchange expense.

This difference is:

1905.....	\$ 13,053.53
1906.....	12,280.80
1907.....	9,804.78
1908.....	6,546.32

"J"

Complainant excepts to the method by which the Master applies depreciation of plant in arriving at a basis of net earnings for each of the four years, 1905 to 1908, inclusive.

On page 84 supra the Master states:

"In regular order, the next items of expense are maintenance repairs. The charges under this heading are for the current repairs, mending breaks, tightening wires, rectifying trouble, and generally maintaining the property in first-class running order."

On page 85 supra he says:

"The next item of expense to be considered is entitled Maintenance Reconstruction. This is a subdivision of Maintenance. The items making up this account are mainly salaries and wages, materials and traveling expenses. Why this separate account should have been kept I cannot understand from the evidence. The witnesses on behalf of Complainant admit that the two accounts, Maintenance and Maintenance Reconstruction, are practically one and the same. Mr. Caldwell says the distinction between them is shadowy."

Both maintenance repairs and maintenance reconstruction are a part of the expense of conducting the business. Maintenance repairs is, as stated by the Master, making current repairs. In other words, maintaining the property in an operating condition, *but no part of maintenance repairs adds anything to the value of the plant, nor, indeed, does it rebuild any part of the plant.*

On the other hand, maintenance reconstruction is not simply taking care of ordinary breaks or ordinary repairs so as to keep the plant in an operating condition, but it is a *renewing*, or a rebuilding of parts of the plant. It is the substitution of new construction for old construction.

It is wholly immaterial to the owner of the plant whether these two items be kept separate or not. Both are items of expense in operating the plant. Both items must be treated as expense of conducting the business precisely as operating expenses, insurance and taxes, and various other expenses necessarily incurred in operating a plant. *It is only important to separate maintenance repairs from maintenance reconstruction when it is desired to ascertain the amount of reserve for depreciation.* Before it can be determined what depreciation is to be set aside, it is necessary to first ascertain how much depreciation has been taken care of during the particular year under inquiry. If the plant has been partially rebuilt, to this extent depreciation has already been taken care of, and nothing is to be set aside for that part of the depreciation, and it is for this reason alone that maintenance repairs must be separated from maintenance reconstruction.

A simple illustration of the difference between maintenance repairs and maintenance reconstruction is given by one of the witnesses:

"If you will let me use the illustration, I will take a suit of clothes. During the time that suit of clothes is kept or worn, it is often brushed, sometimes cleaned by a cleaner, and it is giving good service, but there does come a time, notwithstanding the very best treatment that can be given that suit of clothes by a careful man, the most careful care a man can take of it, that it has to be cast aside, but, up to the day it is cast aside, it is giving, as far as wearing is concerned, one hundred per cent service. Now, during that time, using the suit of clothes in connection with the telephone plant, the plant is being maintained by a percentage or sum of money set apart from time to time as may be necessary to do that, but there comes a time necessarily when that thing actually and in fact goes out of commission and out of service, and must be taken out of the plant. Then comes in the question of falling back on this account which has been set apart for depreciation or *de facto* replacement of the property."

Trans., p. 672.

Maintenance repairs and maintenance reconstruction *do* run into each other. They run into each other because the line of demarcation between what is repairs and what is a replacement or reconstruction is vague and shadowy, and, as stated by Mr. Caldwell:

"It is a hazy line in there that requires very careful auditing to determine just where it should properly belong."

Trans., p. 841.

It is plain that, where a new pole route is substituted for an old pole route, this is replacement, or "maintenance reconstruction;" it is a renewal of that part of the plant which has served its life; and, on the contrary, where wires become so slack that the service is impaired, and employes take the slack out of that wire, and tighten it up, this is current repairs, or "maintenance repairs," because no part of the plant has been renewed, but the same wire has been put into an operating condition. If all reconstruction and all repairs were as plain and simple as these two illustrations of renewal of the pole route and tightening up of the wires, there would be no difficulty; but as these two extremes approach each other, the line of demarcation between what is maintenance repairs and maintenance reconstruction becomes vague and shadowy, and it was in this sense that Mr. Caldwell said that "the line between the two required very careful auditing to determine to which item such expenses should be charged."

But, as heretofore stated, it is of not the slightest concern to the owner of the property to determine whether any particular item of expense shall be charged to maintenance repairs, or to maintenance reconstruction, because both are expenses of conducting the business, and must come out of the gross receipts before there can be any talk of profit. It is important, as stated before, only in connection with the inquiry as to what amount of depreciation has been *cared for* in order to determine what amount of *uncared for* depreciation shall be added to the other expenses, before ascertaining net profits.

At this point it becomes necessary to except to the report of the Master with respect to his treatment of

DEPRECIATION.

On page 87, the Master says:

"I have found, in answer to interrogatory No. 5, that a proper allowance for depreciation will be seven per cent of the value of the plant for each of the years 1905, 1906, 1907, and 1908, and for subsequent years.

"In order, therefore, to make my findings as to the net profit and the percentages thereof, I must show under this division, the amount of such depreciation found, and how it will affect the net earnings."

The Master then gives what he says is seven per cent on the value of the plant as found by him for each of the years in question, and states that the average amount of depreciation allowed for the four years is, per annum, \$92,449.45.

The Master then states, on page 88:

The amount actually expended by Complainant for maintenance and reconstruction for each of said years on an average is \$94,490.19.

The Master then proceeds to find that "the average annual excess of expenditures over allowance for depreciation is \$2,050.74."

The Master then proceeds, on p. 88:

"An analysis of the above figures leads me to believe that in a period of ten or fifteen years, the allowance of seven per cent for depreciation will be ample. An expenditure for maintenance in one year of an amount in excess of seven per cent will probably be followed in the next year by a requirement of a less amount.

"But in ascertaining the percentage of net earnings to the value of the plant, it is proper to deduct from the net earnings as found above, the average excess of the maintenance expense over the average allowance for depreciation."

Upon this basis, the Master proceeds to figure the per cent of net earnings to the value of Complainant's plant as found by him for the four years involved.

Supra p. 89.

"K"

The Master, after allowing seven per cent for depreciation, has included, as a part thereof, maintenance repairs. This is clearly erroneous.

Depreciation is not repairing or maintaining the property or plant in an operating condition. Depreciation is intended to care for silent decay, changes in the art brought about by the evolution in the business, changes required in shifting parts of the plant, owing to the municipal authorities' orders, and unknown but certain disasters which come in a cycle of time.

There is another expense of operating a telephone plant which is not connected with in any way the depreciation of the plant, and that is *maintaining* the property in an operating condition, and called "current repairs," "operating maintenance," "maintenance repairs," or merely "maintenance."

Depreciation does include reconstruction. It embraces reconstruction; and, in addition, embraces evolutions in the art requiring the replacement of parts of the plant that have not worn out, but are replaced because of newer and better apparatus and appliances; and, also, as stated, shifting of plant on account of the necessities of the city, and unknown disasters, or losses, that always come within a cycle of time, and must be provided for out of earnings.

There is no confusion in the record among the witnesses as to "maintenance" and "depreciation."

Mr. Caldwell, Complainant's President, states:

"Depreciation covers—in other words, when I am considering depreciation and when I am discussing it, it covers quite a wide field. Not only is contemplated the wear and tear that is not observable, or that does not require immediate attention, but it also contemplates the changes in the art, the evolution that has gone on and is going on continuously, and the unknown dangers and hazards that are likely to come up and are sure to arise in some form, not at stated intervals, and not perhaps frequently, but will arise in some form or other and call for extraordinary expenditures. That, I say, is the field that I have before me when I am considering the question of depreciation, and the necessity to provide therefor is imperative. As to how it may be treated, or how it may be kept, it is a subject that will vary and has varied with different people in different lines of business, but whether it is reckoned within the accounts or not, does not alter the fact that the force is working its way all the time, and that it will have to be reckoned with inevitably. In other words, it is a force that is not dependent upon the whims or idiosyncracies or opinions of individuals. They are entirely above and beyond any such influences."

Trans., p. 838.

And again, in reply to a question by the Master, he explains the difference between depreciation and maintenance as follows:

"If a brick—if something should fall off of this house, a brick or something, and break our route in two there, men would go there to repair that. The cost of doing that would be Incidental Repairs, and it would go into Maintenance, but it would not be that class of expenditure which would be counted as a thing to perpetuate and renew the property. Now, then, all that class of expenses, if it had gone into Maintenance, would have to be taken out, and excluded before you made up the amount that would represent what you term the equivalent of seven and a half per cent (Depreciation)."

Trans., p. 841.

Mr. Crumb, one of the city's expert engineers, says:

"Assuming there are ten thousand telephones and operating, general and maintenance expense of \$150,000, *there should be added to those expenses the sum of money based upon the actual cash investment in the plant sufficient to cover the depreciation.* Taking the actual cash investment in the plant at approximately one million dollars, and figuring depreciation at seven per cent, would be \$70,000, which should be *added* to the \$150,000, making \$220,000, which would be necessary for the telephone company to earn to cover the actual cost of operation, maintenance, general expense and depreciation."

Trans., p. 904.

Mr. Levings states that:

"In figuring the expenses of operating a telephone plant, you must allow for depreciation, operating, maintenance, and general."

Trans., p. 1535.

Mr. Polk says that:

"In operating a telephone plant, you must allow for general expenses, operating expenses, maintenance expenses, and, in addition, depreciation."

He speaks of maintenance as "maintenance operating," instead of "maintenance repair," as some of the other witnesses call it.

Trans., pp. 1418 and 1419.

In the statement of the estimated expenses as found by the Chicago Commission in 1907, it is shown under what classification telephone expenses should be grouped, and they are as follows:

Operation, maintenance, general, depreciation and interest.

The commission includes under maintenance the following:

Switchboard repairs, etc., line and telephone repairs, cable repairs, conduit repairs, pole line repairs, line wire repairs, telephone and private branch exchange inspections, out orders, plant changes, etc., care of buildings, etc.

After allowing all of these expenses under the head of main-

tenance, the commission, over and beyond this, allows for depreciation and interest.

Trans., p. 831.

It thus appears that the treatment by the Master of depreciation is erroneous, and his findings as to any return for each of the four years from 1905 to 1908, inclusive, is based upon an erroneous conclusion, to which Complainant excepts.

"L"

Complainant excepts to the report of the Master in finding net earnings for the years 1905 to 1908, inclusive, as shown on page 89, and also the percentage of net earnings to the value of Complainant's plant for same years, and that the above percentages are inclusive of allowances for depreciation of property and plant.

First Basis.

This basis is upon the assumption that the Master allows seven per cent per annum of the value of the plant as a proper amount for depreciation.

The Master states in his report, on page 88, that seven per cent depreciation per annum upon the value of the plant, excluding real estate, is reasonable, and that he allows this amount.

But when he comes to apply this depreciation he does so in an improper manner.

The Master finds on page 86 the balance of revenue over expenses to be:

1905.....	\$ 80,830.59
1906.....	101,694.65
1907.....	119,741.78
1908.....	152,723.93

The Master finds, on page 88, the amount which he allows for depreciation to be:

1905.....	\$ 86,818.77
1906.....	93,457.53
1907.....	94,914.66
1908.....	94,606.83

There was actually expended on reconstruction in

1905.....	\$ 41,051.02
1906.....	40,626.07
1907.....	41,895.10
1908.....	31,450.07

Trans., p. 745.

The amount actually expended on reconstruction each year should be deducted from the amount allowed by the Master for depreciation in order to arrive at the balance, or the reserve for unexpended depreciation.

Deducting the amount actually expended on reconstruction from the total allowance by the Master for depreciation gives a balance of:

1905.....	\$ 45,767.75
1906.....	52,831.46
1907.....	53,019.56
1908.....	63,156.76

This balance of the reserve for depreciation as allowed by the Master should be deducted from the revenue as found by the Master in order to arrive at net earnings. This balance deducted from earnings as found by the Master leaves net earnings of:

1905.....	\$ 35,062.84
1906.....	48,863.19
1907.....	66,722.22
1908.....	89,567.17

But this amount must be further reduced, because the Master

has included the entire toll receipts as a part of the exchange earnings. As has heretofore been shown under "I" (p. 107), the most extravagant claim by any one in the record as to the expenses for the toll department for the respective years, are:

1905.....	\$ 23,536.25
1906.....	24,671.90
1907.....	24,478.86
1908.....	20,239.65

Exhibit No. 9, attached to p. 1356 of Trans.

Total toll earnings:

1905.....	\$ 47,542.25
1906.....	52,315.38
1907.....	60,278.24
1908.....	56,942.03

(These toll earnings are arrived at by adding the toll receipts as shown on page supra 80, and the fifteen per cent of toll business allotted to the exchange on page 72, consisting of items 2, 4, 8 and 9.)

If from the total gross toll earnings there be deducted total gross toll expenses, the result will be the net toll earnings which the Master has included in the net exchange earnings. The net toll earnings are:

1905.....	\$ 24,006.00
1906.....	27,643.48
1907.....	35,799.38
1908.....	36,702.38

In order to correctly ascertain the net earnings of the exchange on this basis it becomes necessary to deduct the net toll earnings from the Master's net exchange earnings, as the Master includes gross toll earnings in exchange earnings, and gross toll expenses in exchange expenses, so that if only net toll earnings be deducted from net exchange earnings, as found by the Master, we thus eliminate toll earnings and toll expenses.

The net exchange profits, on the Master's basis, are:

1905.....	\$ 31,011.45
1906.....	48,897.72
1907.....	54,125.47
1908.....	98,018.02

Deducting therefrom the net toll earnings for the respective years, the result is:

1905, net exchange earnings.....	\$ 7,005.45
1906, net exchange earnings.....	21,254.24
1907, net exchange earnings.....	18,326.09
1908, net exchange earnings.....	61,315.64

It will be recalled that the Master deducted \$100,000 from the construction account for the years 1900 to 1908, inclusive, because he said that it was improperly charged to construction. If this \$100,000 is to be deducted from construction, then, a part at least, must be added to the expenses of conducting the business during that period, because a part, at least, according to the Master's report, of this \$100,000 was expended, and the only controversy is as to whether it was expended in operating the exchange, or in adding to the construction account. However, since the Master leaves it uncertain how much of the \$100,000 is expense, no part of it will be added to exchange expense.

If there be deducted the loss which would be sustained under the rates prescribed in the ordinance of...\$ 49,721.76

The result is, for 1908, a net profit of only..... 11,593.88

Second Basis.

This second basis is upon the assumption that Complainant is entitled to no amount for depreciation, beyond the amount actually expended in each year for depreciation.

The Master finds the net earnings to be for:

1905.....	\$ 80,830.59
1906.....	101,694.65
1907.....	119,741.78
1908.....	152,723.93

In order to correctly ascertain the net earnings of the exchange on this basis, it becomes necessary to deduct the net toll earnings from the Master's net exchange earnings, as the Master includes gross toll earnings in exchange earnings, and gross toll expenses in exchange expenses, so that if only net toll earnings be deducted from net exchange earnings, as found by the Master we thus eliminate toll earnings and toll expenses. Eliminating net toll earnings, the result is:

1905, exchange earnings.....	\$ 56,824.59
1906, exchange earnings.....	74,051.17
1907, exchange earnings.....	83,942.40
1908, exchange earnings.....	116,021.55

It will be recalled that the Master, on page 46 *supra*, has deducted ten per cent of the value of the plant for depreciation, *i. e.*, from January 1, 1900, to December 31, 1908, he says the plant depreciated \$138,112.44.

It is apparent that this loss must be considered a part of the expenses of conducting the business. If Complainant had a property which had cost \$1,381,124.41, and it depreciated in nine years \$138,112.44, if the depreciated value is to be accepted as the present value, then the depreciation, or loss in value of the plant, must be added to the expense of conducting the business.

It is also apparent that this \$138,112.44 ought not to be pro-rated in the expense evenly over the nine years, for the reason that there was very much more property to depreciate in 1908 than there was in 1900.

On the Master's basis, the property was worth on January 1, 1900, \$457,579.07.

Supra p. 9.

There was only added to construction that year \$166,775.23.

Trans., p. 761.

So that at the end of the year 1900, on the Master's theory the property had cost only \$624,354.30; whereas, at the end of 1908,

the Master finds the property had cost \$1,381,124.41. It thus appears that this \$138,112.44, should *not* be pro rated evenly over the nine years, but a much *larger* proportion should be pro rated on the last four years than on the former years. However, if it be prorated evenly over all the years, the result is a total annual deduction of \$15,345.82, the one-ninth of \$138,112.44.

This deducted from the net earnings as above, leaves real net earnings on the Master's basis of:

1905.....	\$ 41,478.77
1906.....	58,705.35
1907.....	68,596.58
1908.....	100,675.73

If there be deducted the loss which would be sustained under the rates prescribed in the ordinance of..... \$ 49,721.76
The result is, for 1908, a net profit of only..... 50,953.97

Third Basis.

This third basis is upon the assumption that the Master should have allowed the 15 per cent of toll receipts to the exchange as sufficient compensation for its service to the toll lines.

The amount of net earnings as reported by the Master, on p. 86, is:

1905.....	\$ 80,830.59
1906.....	101,694.65
1907.....	119,741.78
1908.....	152,723.93

Included in these net earnings are the total toll earnings.

Supra p. 80.

These toll earnings, over and above the fifteen per cent allowed the exchange, amount to:

1905.....	\$ 37,059.53
1906.....	40,034.58
1907.....	45,504.16
1908.....	43,248.70

If this should be deducted from the net exchange earnings, as found by the Master, the result is:

1905, net earnings.....	\$ 43,771.06
1906, net earnings.....	61,660.07
1907, net earnings.....	74,237.62
1908, net earnings.....	109,475.23

There must also be deducted a proportionate amount of the depreciation deducted by the Master from the construction account, as shown on page 46, of \$138,112.44.

As has heretofore been pointed out, it is not fair to deduct only the one-ninth part of this depreciation from each of the last four years under consideration. A much larger amount than an equal pro rata should be allowed as heretofore shown. However, if the total depreciation of \$138,112.44 is pro rated *evenly* over the entire nine years, the result is for each year \$15,345.82.

If this item be deducted from the Master's net earnings for each of said years, it reduces the Master's net earnings to:

1905.....	\$ 28,425.24
1906.....	46,314.25
1907.....	58,891.80
1908.....	94,129.41

If there be deducted the loss which would be sustained under the rates prescribed in the ordinance of.....\$ 49,721.76
The result is, for 1908, a net profit of only..... 44,407.65

Mutual Audit Company's Basis.

It will be recalled that the Mutual Audit Company, the accountants selected by the Defendant, made a separate report to the Master, and in this report they find the net earnings for the years in controversy to be as follows:

1905.....	\$ 101,010.80
1906.....	118,737.95
1907.....	130,012.58
1908.....	151,612.74

Trans., pp. 1372 to 1374.

These net earnings are arrived at by eliminating what is called toll expenses and toll revenue. There is also eliminated for each of the years the exact amount spent by Complainant on reconstruction, and nowhere is this expense charged in the operation of the exchange for the respective years. They simply deduct the amount expended on reconstruction, stating that this amount should be charged against reserve, but nowhere do they create a reserve to which this reconstruction can be charged.

Trans., p. 1322.

The amount of reconstruction for each year, as found by the Master on p. 85, is as follows:

1905.....	\$ 41,051.02
1906.....	40,626.07
1907.....	41,895.10
1908.....	31,450.07

Deducting these amounts from the net revenue as reported by the Mutual Audit Company leaves net revenue on this basis of:

1905.....	\$ 59,959.78
1906.....	78,111.88
1907.....	88,117.48
1908.....	120,162.67

The Master has stated that the plant has depreciated in the nine years \$138,112.44.

Supra p. 46.

If only one-ninth of this amount be deducted for each of the years, which, as above shown, is manifestly unfair, it will result in a further reduction of net earnings of \$15,345.82 for each of the years. Deducting this amount leaves net earnings on the Mutual Audit Company's basis for each of the years as follows:

1905.....	\$ 44,613.96
1906.....	62,766.06
1907.....	72,771.66
1908.....	104,816.85

The Mutual Audit Company, in arriving at this result, has deducted expenses which they insist should have been charged against other exchanges, as explained in "G" (p. 101). If these amounts, erroneously deducted by the Mutual Audit Company, be added in expenses for the respective years, it would result in the net earnings, as given above, on the Mutual Audit Company's basis, being further reduced, as follows:

1905.....	\$ 11,412.71
1906.....	11,712.34
1907.....	11,182.78
1908.....	6,392.72

This, deducted from the net earnings as above shown, leaves the net earnings on the Mutual Audit Company's basis:

1905.....	\$ 33,201.25
1906.....	51,053.72
1907.....	61,588.88
1908.....	98,424.13

If there be deducted the loss which would be sustained under the rates prescribed in the ordinance of.....\$ 49,721.76
The result is, for 1908, a net profit of only.....48,702.37

The Master finds the value of the plant, exclusive of toll lines and real estate, to be.....\$1,243,011.97

Supra p. 46.

The net earnings on the report of the Master are:

First basis, 1908.....	\$ 11,593.88
Second basis, 1908.....	50,953.97
Third basis, 1908.....	44,407.65
Mutual Audit Co.'s basis, 1908.....	48,702.37

Summary.

Gross earnings:

The Master, following the joint report of the accountants, reported gross earnings:

1905.....	\$ 269,823.38
1906.....	294,498.44
1907.....	319,758.51
1908.....	325,838.30

This includes the 15 per cent of tolls.

Gross expense:

The Master reports gross expenses, as shown in the joint report of the accountants:

1905.....	\$ 227,171.29
1906.....	233,898.28
1907.....	246,598.61
1908.....	217,395.53

Unless Complainant is bound by the joint report of the accountants, these gross expenses must be increased, as shown in "G" (p. 101), as follows:

1905.....	\$ 11,412.71
1906.....	11,712.34
1907.....	10,886.81
1908.....	6,392.79

The real gross expenses, which the Master should have reported, will be, after adding these omitted items last above set out, the following:

1905.....	\$ 238,584.00
1906.....	245,610.62
1907.....	257,485.42
1908.....	223,788.32

The Master should, therefore, have reported the balance of revenue, after deducting expenses, as follows:

1905.....	\$ 31,239.38
1906.....	48,887.82
1907.....	62,273.09
1908.....	102,049.98

The foregoing does not include any allowance for depreciation, *except* the actual amount expended for each of the years on reconstruction. It is only important to show that for the year 1908 the amount expended was only.....\$ 31,450.07
 Supra p. 85.

Rates Prescribed by Ordinance.

If the rates prescribed in the ordinance had been in effect in 1908, the net profit would have to be reduced by..\$ 49,721.76

Leaving a balance of revenue over expenses for the year 1908 of..... 52,328.22

From this amount there must be deducted *incomplete* depreciation of whatever amount may be allowed.

If the depreciation be allowed as found by the Master on p. 88, amounting to\$ 94,606.83

The reserve for, or the incomplete depreciation, will be reduced by..... 31,450.07

Leaving a reserve for depreciation of..... 63,156.76

Or a net loss under the ordinance rates of..... 10,828.54

Complainant excepts to the report of the Master, because he did not so report.

THE MASTER'S REPORT.

IV.

"The said Special Master is directed to make an estimate upon the testimony, and state his conclusions therefrom, as to what would be the reasonably probable gross and the reasonably probable net income of the Complainant from its said plant and property employed in its business in said city for the current year, and the year 1910, if the rates of telephone charges fixed by the ordinance enacted by the legislative body of Defendant and approved by the Mayor on March 6, 1909, should be put into operation and effect.

The accountants, in their Joint Report, agree that if the ordinance rates be put into operation, the loss in revenue to Complainant annually would probably be \$49,721.76. From what subsequently appears in their Joint Report, this loss is based upon the hypothesis that this loss will result if there should not be an increase or decrease in the number of subscribers.

The accountants then agree on the following statement:

"Against this probable loss of \$49,721.76 a year, will probably be an increase in gross earnings in respect of the natural growth of the business and the increased number of subscribers due to the lowering of rates upon the enforcement of the ordinance. What this increase will amount to, we cannot definitely determine."

It must be borne in mind that the practical effect of the ordinance rates has not been tried. Complainant comes into a Court of Equity and seeks, by injunction, to prevent the operation of the proposed rates, upon the ground that their enforcement would be confiscatory of its property.

In *Knoxville vs. Water Works*, 212 U. S., 16, the Court says:

"It must be prepared to show to the satisfaction of the Court that the ordinance would necessarily be so confiscatory in its effect as to violate the Constitution of the United States."

In their separate reports, the two accountants widely differ as to what will be the net results, if the rate ordinance be put in operation. The accountant of Complainant very adroitly argues, and furnishes figures in support of his contention, that the net loss to Complainant, if the ordinance rates be adopted, would be, in 1910 (1911) \$18,852.97, and that this net loss would probably decrease annually thereafter.

The accountant of the city does not go into detail as to calculations to the same extent as does Complainant's accountant, but states that the net increase in earnings would be:

In 1910 (1911).....	\$ 14,972.40
And would be in 1911 (1912).....	21,441.82

The reasoning of both accountants on this subject is speculative and hypothetical. Both admit that the lowering of rates will produce an increase in the number of subscribers, and consequently in gross earnings. They also agree that an increase in the number of subscribers will entail an increase in Operating Expenses. One says this increase in expenses will be nominal; the other says it will be substantial.

It is impossible to foresee whether the expected increase in subscribers will be in respect of business 'phones or residence 'phones. This uncertainty must necessarily affect the expected gross revenue. And, to a certain extent, this uncertainty will affect the operating expenses, and consequently the net revenue.

Complainant's accountant shows from the books that the operating expenses vary in a sort of ratio to the number of subscribers. He says in 1906 there were 5,956 subscribers, and the operating expenses were \$80,738.06. In 1908, he says, there were 5,158 subscribers—800 less than in 1906—and the operating expenses that year were \$75,440.28. He argues, therefore, that a loss of about 800 subscribers shows a decrease in operating expenses of about \$5,300.00. This calculation shows an annual saving in expenses of about \$6.50 for each subscriber lost.

The statement of this contention shows it is an unreliable basis

of calculation. No account is taken of the other Operating Expenses, and they would have to be analyzed before the above figures could be safely relied upon.

Again, Complainant's accountant assumes that many subscribers who are not content with party lines, will take a private line, and that this probable condition would result in little net increase of revenue.

The views of the two accountants are irreconcilable as to the net results of a lowering of rates. But they do agree that the primary result of the lowering of rates would be an increase in the number of subscribers, and that the operating expenses would thereby be increased, but to what extent there is uncertainty.

It is obvious that the increase in the number of subscribers is deemed desirable by Complainant. The evidence throughout this record shows that Complainant's efforts are mainly directed to this end, and I am persuaded that every such increase must be remunerative to Complainant. After a certain increase in the number of subscribers is reached—say one hundred—it becomes necessary, in the proper conduct of the business, to add two additional operators to the company's force; in addition, a small annual percentage of other expenses becomes necessary, such as additional wiring and maintenance. These items must be considered. Complainant's accountant produces a computation showing that if the ordinance rates be enforced, it is fair to estimate that there will be a natural increase of 483 subscribers the first year, which would probably require 800 stations; and that the taking on of the 483 new subscribers would be at a net loss to Complainant for the year 1910 (1911) of \$1,294.00. I cannot accept this result as reasonably probable.

The suggestions of Defendant's accountant on this subject are not satisfactory. Neither accountant seems to have considered all the essential elements of this extremely hypothetical question. For instance, Complainant insists that new wiring would be a necessary expense of putting on the new subscribers. This item appears to have been heretofore charged uniformly to Construction Account. The charge for Maintenance or Maintenance Reconstruction for the first

year would be nominal, and after the second year it would probably be a negligible quantity, in view of the reasonable expectancy that the increase in new subscribers would be continuous.

Defendant, on the other hand, suggests that the salaries and wages of additional operators and Main Office clerks would be merely nominal, as compared with the gross revenue to be received from the new subscribers.

Without discussing this question further, I find that if the ordinance rates be enforced, there will be an increase in the number of telephone subscribers; but the number of such new subscribers is problematical. The new subscribers will probably be of two classes:

(a) Those secured as the result of the natural growth and extension of business;

(b) Those who may be induced to become subscribers as the direct result of a lowering of the rates.

It appears in evidence that many persons cancelled their subscriptions in 1908 when the rates were raised. It is reasonable to expect very many of these to renew their subscriptions.

It is not possible for me to do more than to express my opinion as to how large will be the increase in the number of new subscribers in case the ordinance rates shall be enforced, nor as to whether the new subscribers will require business 'phones or residence 'phones. All the witnesses who speak of this subject express the opinion that there would be a substantial increase in the company's business. But only two witnesses went further and hazarded a guess as to the probable number or as to the probable financial results.

I am of the opinion that the first year after the new rates shall be in force, say 1911, the net decrease to the company in revenue will probably amount to \$30,000.00 below what the Net Earnings have been found to be under present rates in 1908.

In 1912, I am of the opinion that the gain to the company will probably be large and continuous, and that it will probably overcome

the decrease in net revenue entirely. In other words, I believe that in 1912, the net income of Complainant under the ordinance rates would be equal, if not greater, than those for 1908, as given supra under present rates.

In the above findings I have assumed that the net earnings of the company have remained in 1910 as I have found them to be in 1908. But it is not unreasonable to suppose that they were greater in 1910 than they were in 1908 or 1909.

But adopting the net earnings of 1908, as I have found them, under the present ordinance \$ 150,673.19

And deducting what will be the probable loss in 1911
if the ordinance rates be enforced as stated above 30,000.00

The net earnings of the company for the year 1911
under the ordinance rates will probably be \$ 120,673.19

If the value of the plant be assumed to be in 1911 \$1,400,000.00
The net earnings as shown, without considering any increase, would yield to the Complainant, net 8.60 per ct.
on the then value of the plant.

EXCEPTIONS OF APPELLEE.

The Master states, on page 125, that the joint report of the accountants agreed that if the ordinance rates be put into operation, the loss in net revenue to Complainant would amount to \$49,721.76.

"X"

Complainant excepts to the statement of the Master on page 128, as follows: "I am of the opinion that after the new rates shall be in force, say 1911, the net decrease to the company in revenue will probably amount to \$30,000 below what the net earnings have been found to be under present rates in 1908."

The joint report of the accountants, as has heretofore been shown

and as reported by the Master, states that the loss in revenue under the ordinance rates will amount to \$49,721.76 per annum. The record shows beyond any controversy whatever that there will be no decrease in expenses in operating the exchange if the rates prescribed in the ordinance be put into effect.

It is also shown in the record, and without any contradiction, that any increases in patronage will entail *at least* a corresponding increase in expenses, and also in capital account, *i. e.*, new subscribers obtained will necessitate new construction to serve them. In this respect the telephone is different inherently from all other known kinds of business. A water company, gas company, street railway and other like public service companies obtain additional patronage without a corresponding increase in expenses and capital account. They may obtain new patrons without the necessity of increasing their facilities. A new patron enters a street car and pays his fare. This does not entail upon the company the necessity of increasing its equipment, and does not increase its expenses appreciably. The gas company may obtain a new patron and he is served by the existing facilities and appliances, and so with the water company and other public service companies, excepting the telephone company. Each new subscriber of the telephone company must have his own wires leading from his place of business or residence to the exchange. He must have his separate and distinct instrument, which must be installed for his use; his wires at the switchboard must be connected in such way that he may have access to all other subscribers, and all other subscribers may have access to him, which means that increased patronage calls for increased facilities, which brings *at least* a corresponding increase in operating, maintenance and other expenses.

This principle is recognized by the Supreme Court of the United States in *La. R. R. Com. vs. Cumberland Tel. Co.*, 212 U. S., p. 426.

The Court says:

"We say this because the evidence shows that in the case of telephone companies the general result of a reduction of rates in some other kinds of business does not follow,

namely, that there would be an increased demand, which could be supplied at a proportionately less cost than the original business. Such, it is admitted, would be the case generally in regard to water companies, gas companies, railroad companies, and perhaps some others, where the rate is a reasonable one. For example, it is said that it would cost no more, or certainly scarcely an appreciable amount more, to haul a train of two cars both filled than it would to haul the same train with both cars half filled, and if the reduction in rates should result in filling the cars where previously they had not been half filled, there might be an increased carriage at a cost very little more than before, and probably an increased profit. So, in the case of a water company, the reduced rate might result in furnishing more water to consumers already existing, and the increased cost of furnishing the same would be infinitesimal, where there was a supply sufficiently large to fill the demand. So, also, in furnishing gas at reduced rates, the reduction in the rate would very probably result in increased consumption, not only in increased demands from more consumers, but also an increased consumption by consumers already existing, and the increased cost of furnishing the gas would be nothing like in proportion to the increase in consumption. In these cases increased profits might be the results of decreased rates. But with telephone companies, as shown by the testimony of the president of the Complainant, the reduction in toll rates does not bring an increased demand, except upon the condition of corresponding increase in expenses."

The evidence in the record with respect to the future in operating on the schedule of rates prescribed in the ordinance is as follows:

JAMES E. CALDWELL, *President of Complainant.*

This witness states, in reply to an inquiry as to the policy pursued with respect to rates by himself and associates as compared with the policy pursued by the former owners and managers of the Louisville property:

"The former owners had two rates. They had one business rate, that is to say, they had a rate for private or direct telephones, and a rate for private or direct residence purposes. We endeavored to make a variety of rates which

would meet the requirements and wishes of every phase of the community. Our effort was to put the service within reach of everyone in the community. We adopted schedules of rates that were not only a modification of the direct or private business service and the private or direct resident service, but public stations, party-line stations, measured service, and, in the greatest variety, and extending this service not only to the suburbs but well out into the country around Louisville, extending toll line facilities in every direction out of Louisville, so as to offer that community the very greatest sort of value, and expansiveness in the telephone service, we extended it to farmers, market gardeners, dairymen, summer residences, etc., and we endeavored to reach every class and kind of business and individual."

Trans., p. 508.

Again, he says that any decrease in earnings will not decrease expenses; and in reply to an inquiry as to what would be the result to the Complainant if there should be an increase in subscribers owing to the reduced rates, he says:

"Well, if you increase your subscribers you would be compelled to increase your facilities and your capital account. You would be compelled to increase your operating force to take care of the greater number of calls that would go over the system; you would have to encounter certainly a shifting of customers from one class of rates to another, which expense you would be certain to meet, but you do not know what it would be. The growth that would take place in that, you could not tell whether it would be on the maximum or the minimum, or in what direction in the city it would be found; it would all be a matter of speculation so that to forecast the future on that is a matter of speculation and doubt."

Trans., p. 512.

And again, he says:

"My opinion is that we would have to provide a considerable additional capital outlay; that we would get little or no additional gross revenue, certainly we would not get more than would be offset by the additional expense. My

deliberate opinion is, it would be a very losing and disastrous experiment."

Trans., p. 513.

LELAND HUME, *General Manager*.

Mr. Hume states that no man who had any practical experience, or any reasonable information about the business, would be willing to say that if the rates prescribed in the ordinance should be put into effect, that it would result in an increase in patronage without *at least* a corresponding increase in expense. He says such a statement is not a fact, and could not be. On the contrary, he says that an increase in the number of subscribers would entail an increase in the expense of conducting the business, that it would not decrease expenses in any way per subscriber; that an increase in patronage would bring about a proportionate increase in the cost of operating the telephone per subscriber, and that it would be impossible for it to decrease expenses.

Trans., pp. 699 and 700.

He further states:

"When we purchased the Ohio Valley Telephone Company we found what we considered a very small development of the telephone business in Louisville; we promptly set about to provide facilities that would enable us to take on business very rapidly, believing that by providing the facilities that we could then secure the business, and we set about it with the best traffic men that we could procure, men who had established themselves as good traffic men, and solicited business. The rates that the Ohio Valley Telephone Company had formerly charged were not increased, notwithstanding the fact that we proposed to add largely to the exchange if we could, but as the business did not respond except very slowly, we retained those rates, but at the same time added a schedule of rates that were considered very attractive, offering various kinds of service, including the metered service, and measured service, and pay station service, following plans that had been successful in other large cities. Those rates brought about some increase in business, but nothing phenomenal, or nothing that we

thought was in accord with what should be accomplished, and as a consequence, we have, from time to time, put out schedules of rates with attractive features, and we have offered, at Louisville, all the features that were attractive and that were taken hold of by other communities, and I can state that we have never conducted our business in any place where more study has been given to the question of placing before the public various types of service and plans for service than has been done by us in the city of Louisville."

Trans., p. 700.

H. BLAIR SMITH, *Auditor*.

Mr. Smith states that a reduction in rates would not decrease the expenses

Trans., p. 227.

These witnesses not only have a very large experience in the telephone business, but have an intimate knowledge and experience with the operation of the Louisville plant.

Turning to the evidence of the Defendant, we have the same result.

W. H. CRUMB.

Mr. Crumb is a telephone engineer. He states, "Based upon the flat rate basis of charging for telephone service, in my opinion, there is a slight increase in producing telephone service in a given locality in large quantities over what it costs to produce telephone service in moderate quantities, but I believe the cost is often considerably overestimated, and, in fact, very generally overestimated by telephone people; that the cost is not so great as is usually believed to be."

Trans., p. 908.

This simply means that in Mr. Crumb's opinion there would be a slight increase per subscriber in expenses as the number of subscribers increases.

W. C. POLK.

Mr. Polk is also a telephone engineer. He states that as the number of subscribers increases the cost of the plant must also increase.

Trans., p. 1434.

He also states that the effect of putting into force the rates prescribed in the ordinance would result in an increase in the number of subscribers, and that this would result in an increased capital account, and that it would result in an increase in all expenses of conducting the business; that a reduction in rates would not reduce the expenses at all, but that an increase in patronage would increase the expenses per station to a certain point.

Trans., p. 1439.

Mr. Polk also says, when asked in regard to the reasonableness of the rates prescribed in the ordinance, that he would not be willing to invest his money in a plant only costing \$1,300,000, including real estate, if it was to be operated on the rates prescribed in the ordinance; and that it would be a risk he would not care to take if his money was involved to any large extent; he might be willing "to take a gamble" for a small amount.

Trans., pp. 1439 and 1440.

In the report of the Committee to the City Council of Chicago, September 3, 1907, it is said on page 12:

"The average person does not understand why it costs more per telephone to supply telephone service in a large city than in a small city. The assertion of this principle to many seems a paradox. It is regarded as contrary to the ordinary principle of business—that is, that the unit cost becomes less as the volume of business done increases. It is but natural to think that the wholesale principle ought to apply in the telephone business as in other lines. This idea prevails because the ordinary individual does not understand the peculiar features of the telephone business, and does not look beyond the telephone on the wall or on the desk. He does not take into consideration that the real business of a telephone is to furnish service, transmit messages, and not merely to rent instruments.

This prevailing idea has been constantly brought home to the members of the committee by having their attention called by people thus uninformed to the lower rates existing in other cities; cities between which and Chicago there can be no common basis of comparison. Attention is called to some of the reasons for this exception to that rule of business, so well established."

There is attached as an exhibit to the deposition of Mr. Caldwell a pamphlet giving the reasons why increased patronage entails a proportionate increase in expenses.

Trans., p. 552.

This pamphlet was handed to Mr. Crumb, and he was requested to read it.

Trans., p. 917.

After reading it, he stated that he did not have anything to say specific in reply thereto other than what had been said generally in his deposition.

Trans., p. 952.

But as has heretofore been shown, Mr. Crumb said nothing in his deposition contrary to this known fact in the telephone business, but sustains what is therein said.

There is but one suggestion to the contrary in this entire record, and that is the separate report of the Mutual Audit Company, the so-called experts employed on behalf of the Defendant. In this report it is claimed that a lowering of the rates would result in an increased patronage, and that this would result in increased profit.

Trans., p. 1323.

Mr. Farnham, who wrote this report (Trans., p. 1116), is not a telephone engineer, has never had any experience in the telephone business, and does not appear to know anything about the business (Trans., p. 703). On the contrary, it appears that when he was first employed he went to see Mr. Crumb, a telephone engineer, to ascertain along what lines his investigation of Complainant's books should be made.

Trans., p. 946.

Mr. Wilkinson, the expert for Complainant, gave his deposition, and full opportunity was given to test any statements made in his report, *but* Mr. Farnham did not give his deposition, and no opportunity was given Complainant to cross-examine him and test either his accuracy or his means of knowledge.

In view of the undisputed evidence in this record by all the witnesses qualified to speak, if the rates prescribed in the ordinance of Defendant should be put into effect, it would result in the immediate reduction in gross revenue of nearly \$50,000; it would *not* result in any decrease in expenses, and it would certainly result in a large increase to the capital account, if new subscribers were obtained, and these new subscribers would entail *at least* a corresponding increase in expenses.

The Master seems to have relied upon theories of *bookkeepers* to the exclusion of *practical telephone men*, testifying on behalf of Complainant and Defendant. It is not to be expected that bookkeepers will be able to forecast the future as to telephone rates, and the only people who have a right to hazard an opinion upon such a subject are those who have had actual experience in the business, or show themselves to have made a study of the matter.

A reading of the reasoning of the Master upon this branch of the case clearly discloses that he has not considered the statement of any witness in the record except the bookkeepers of the Mutual Audit Company, neither of whom appears to have had any experience whatever in the telephone business, or the experience of examining the accounts of a telephone company.

The Master agrees that the joint report gives the annual loss in revenue under the ordinance rates as \$49,721.76.

Supra p. 125.

On p. 128, he says:

"I am of the opinion that the first year after the new rates shall be enforced, say 1911, the net decrease to the company in revenue will probably amount to \$30,000.00 below what the

net earnings have been found to be under present rates in 1908."

To bring about this result it is clear that the revenue of the exchange operating under the ordinance rates must increase enough after they are put into effect to add the difference between \$49,721.76 and \$30,000.00 to net revenue. The loss to be thus recouped is.....\$ 19,721.76

The greatest amount of net exchange revenue for 1908 under the various bases (p. 122) is \$50,953.97. The net revenue to be recouped, \$19,721.76, is 38.7 per cent of this amount.

The Master reports the cost of the exchange plant, exclusive of real estate and toll lines, as\$1,381,124.41
Supra p. 46.

It is submitted that under the evidence, to gain 38.7 per cent in net exchange revenue it will require at least an addition of 38.7 per cent to exchange plant. That is, new capital must be added to the extent of 535,495.14

So that, at the end of the first year, the exchange plant alone, excluding real estate, will have cost at least \$1,916,619.55
And not, as the Master estimates on p. 129, viz..... 1,400,000.00

On an earnings basis it is also shown that the Master is in error.

The value of exchange plant with toll lines added is estimated by the Master to be at the end of the first year \$1,400,000.00
And the present value of the same plant he gives on p. 46 as..... 1,355,878.09

Making the new capital to be added the first year..... \$ 44,121.91
Which, he says, will produce \$19,721.76 net revenue. That is, the new capital will produce 44.7 per cent net revenue, annually, while the ordinance rates are said to be only reasonable rates, and only capable of producing a fair return upon the capital invested.

Again, the number of telephones in use in the exchange
is (Trans., p. 624)..... 9,395

The revenue of the exchange is derived from the ex-
change telephones, and to increase the net revenue 38.7
per cent, it will be necessary to add 38.7 per cent to the
present number. This will require a gain of 3,636

Making the total number at the end of 1911 13,031

For these reasons, Complainant excepts and insists that:

The Master should have reported that the reduction in revenue under the rates prescribed in the ordinance would have been \$49,721.76; and that a reduction in the rates would not have in any way decreased expenses. Also, that a decrease in rates would probably result in increased patronage, which would necessitate an increase in cost of construction, and at least a corresponding increase in expenses.

THE MASTER'S REPORT.

V.

"He will ascertain and report from the testimony what would be a fair amount or proportion of annual income to set aside as a substantial provision and allowance for depreciation of Complainant's plant and property employed in its business in said city and the basis of his estimate thereof."

The evidence as to depreciation presents a diversity of views as to what proportion of the annual income of Complainant should be set aside as a provision and allowance to cover depreciation of plant and property employed in Louisville by Complainant.

The general officers of Complainant say that the annual allowance for depreciation should be ten per cent of the value of plant and property. Mr. Smith, the Auditor of the Complainant, fixes seven and a half per cent as the proper amount, and Complainant's accountant says seven per cent will be sufficient. They all admit that the annual outlay for Maintenance and Reconstruction must be deducted from the Depreciation Fund.

In taking up this question, it is a noteworthy fact that no amount has ever been set aside for depreciation by Complainant. The reason alleged is that the earnings of the company have not been sufficient to provide such an outlay. It is insisted by Complainant that in those years when its earnings were not sufficiently large to enable it to set aside a fund to cover depreciation, the deficit should be taken care of out of the earnings of subsequent years. This deficit, it is claimed, represents incomplete depreciation.

Before discussing the actual figures as disclosed by the evidence, I may say that this claim of Complainant is disposed of by the Circuit Court of the United States in *Knoxville vs. Water Company*, 212 U. S., 13, 14, where the Court says:

"Before coming to the question of profit at all, the company is entitled to earn a sufficient sum annually to provide not only

for current repairs, but for making good the depreciation and replacing the parts of the property when they come to the end of their life. The company is not bound to see its property gradually waste without making provision out of earnings for its replacement."

On page 14 the Court says further:

"If, however, a company fails to perform this plain duty and to exact sufficient returns to keep the investment unimpaired, whether this is the result of unwarranted dividends upon over issue of securities, or of omission to exact proper prices for the output, the fault is its own.

When, therefore, a public regulation of its prices comes under question, the true value of the property then employed for the purpose of earning a return cannot be enhanced by a consideration of the errors in management which have been committed in the past."

While this record does not show that unwarranted dividends have been paid out of earnings, it is claimed by Complainant that the company failed to earn a sufficient amount to cover the annual depreciation of its plant and property in 1905, 1906, 1907 and 1908, and therefore the Court must allow it to apply, out of future earnings, a sum equal to the deficits of former years, as compensation for the incomplete depreciation. In other words, Complainant contends that in 1905, 1906, 1907 and 1908 its earnings at the then existing rates were sufficient to take care of all operating expenses, taxes and insurance, maintenance and reconstruction, but not enough to cover the incomplete depreciation of plant; that the depreciation is not always annual, but, in a long period of time, the plant will require rebuilding or replacement, and it is necessary to begin and lay aside a fund each year, which fund, at the end of a period, will provide the amount necessary to overcome depreciation.

I have considered all of the evidence in the record, and I am satisfied that a fund to cover depreciation of plant is necessary, and this fund should come out of earnings. It has been shown that some parts of the plant begin to depreciate the moment they are put into use, while other parts last unimpaired for years. The poles will last, on

an average, ten years or longer. The wires are shorter lived. The conduit system is of long life—fifty years and longer. The switchboards, under the evidence, last many years. They are composed of separate parts or sections, and by replacing an impaired part or section, the life of the switchboard is extended indefinitely. The only hazard in respect of switchboards is the discovery and introduction of a better pattern. The evidence shows that the switchboards in Louisville are of the best and most approved type as to efficiency and lasting qualities. Thus it is obvious that the percentage of depreciation of the various parts of the plant and property is not subject to a general law or rule. To establish an average is beyond my power, as the evidence does not aid me in this regard.

I will now direct attention to what the Complainant has actually done with reference to depreciation since 1905.

Its books show, as appears in the Joint Report of the accountants, that in 1905, 1906, 1907 and 1908, Complainant expended in repairs or Maintenance and Reconstruction in Louisville, not including real estate.....\$ 377,960.55

This gives an average per year of..... 94,490.14

On the value of the plant, as I have found it, as of March 6, 1909, to-wit:..... 1,355,878.00

The above expenditure is, each year, on an average... 7.046 per cent

In addition to this expenditure, it is insisted by Complainant, that for the four years supra, there remains an "unexpended portion of Reconstruction Reserve to be charged against future earnings".....\$ 301,640.45

This amount is an average per year of..... 75,410.11

This claim each year is an average of..... 5.62 per cent

These two amounts added together make.....\$ 679,601.00

Or an annual percentage for depreciation of over..... 12 per cent

The statement of the above figures are startling, when the evidence discloses that the Home Telephone plant in Louisville, which is, in many respects, similar to Complainant's plant, was built anew for about \$1,000,000.00. Witnesses for Complainant all testify in substance that the company's plant in Louisville is in nearly perfect condition in all respects.

It may be mentioned in passing, that during January, February, and to the 6th of March, 1909, Complainant spent only \$491.65 for Maintenance and Reconstruction. This fact may fairly be accounted for by assuming that no greater outlay was required for such purpose.

I think it is reasonable and fair to assume that the amounts actually expended by Complainant during 1905, 1906, 1907 and 1908, and to March 6, 1909—made, as they were, when this or similar litigation was not contemplated—indicate more clearly than opinions of witnesses what expenditures were necessary to properly repair, maintain and reconstruct the plant. The plant was acquired in 1899, and Complainant took care of and maintained the plant up to 1905 just as it has done since that time.

In that part of the report where the cost of the plant was considered, reference was made to a questionable entry in the books of the Ohio Valley Company. It appeared that that company paid dividends on its capital stock, maintained and reconstructed its plant from year to year out of exchange earnings during a period of eight or nine years. At the end of each fiscal year the Ohio Valley Company wrote off from its "Construction" Account, and passed to "Depreciation" an amount aggregating \$135,505.70.

Complainant attacks these bookkeeping entries vigorously, and in its Construction Account, it has reversed the entries made by the Ohio Valley Company *supra*, and that aggregate item of \$135,505.70 appears as an integral part of the cost of Complainant's plant immediately after it was purchased from the Ohio Valley Company in 1899.

As to the correctness of this addition of \$135,505.70 to Construction Account, and therefore to the Cost Account of the plant, its expert accountant, Mr. Wilkinson, on page 758 of the *ans.*, says:

"No such charge for depreciation was called for at all. *The amount actually expended by the Ohio Valley Telephone Company upon the upkeep of its telephone plant, was ample to provide for all reconstruction.*"

This argument, when applied to the claim of Complainant for an additional allowance out of earnings for "incomplete depreciation" over and above the annual outlay for Maintenance and Reconstruction, is conclusive. In further support of the justness of my position, I may refer again to the testimony of Complainant's witnesses, who say that the *physical condition of the plant is first-class in every respect.* (Trans., p. 766 states books in good order.) (Wilkinson's Report, p. 26.) (Smith & Caldwell.)

Again, the claim for depreciation is made on supplies, amounting to an average of \$37,711.79 for the years 1905, 1906, 1907 and 1908, and it is also claimed that this Depreciation Fund should be based on the cash working capital used by Complainant amounting on an average for each of the four years to \$28,597.45.

The claim to this extent ought not to be allowed.

I wish to say further, that the claim for an annual depreciation of seven per cent on the conduit system and the switchboards, is, in my opinion, not sustained by the evidence. If the value of the conduit system and of the switchboards and of supplies and of cash, be taken from the total value of the plant, it will appear that the amount actually expended each year for Maintenance and Reconstruction is substantially more than seven and a half per cent claimed by the company's officers as proper.

I do not intend by the foregoing to hold that there is no depreciation as to the conduit system and as to the switchboards. All I intend is that the depreciation as to these items ought not to be on a basis of seven and a half per cent per annum.

In view of the foregoing, I find that the fair and reasonable amount or proportion of annual income of Complainant that should be set aside as a substantial provision and allowance for depreciation of Complainant's plant and property employed in its business in Louis-

ville, and including everything except cash working capital and supplies, would be an amount equal to seven per cent of the value of the plant, as above limited, and that the amount expended annually for Maintenance and Reconstruction of the plant should be deducted from the seven per cent fund.

EXCEPTIONS OF APPELLEE.

The Master states, in concluding on this subject, page 144:

"In view of the foregoing, I find that the fair and reasonable amount or porportion of annual income of Complainant that should be set aside as substantial provision and allowance for depreciation of Complainant's plant and property employed in its business in Louisville, and including everything except cash, working capital and supplies, would be an amount equal to seven per cent of the value of the plant, as above limited, and that the amount expended annually for maintenance and reconstruction of the plant should be deducted from the seven per cent fund."

Complainant excepts to the report of the Master in that he states that while seven per cent is a proper amount to set aside for depreciation, there should be deducted from this all amounts expended annually for maintenance and reconstruction.

The basis upon which Complainant insists upon depreciation, and, so far as this record shows, the only basis that any witness adopts is to set aside a fund equal to whatever per cent of the cost of the plant is thought to be proper by the respective witnesses as a depreciation fund. Whatever amounts are expended during the year for rebuilding or reconstructing any parts of the plant are deducted from this per cent, whatever it may be, and the remainder is the unexpended depreciation fund, or what is sometimes called a reserve or a fund to take care of incomplete depreciation.

It is not proper treatment to charge against this depreciation fund any of the expenses incurred for maintenance of plant. When a plant is being maintained in an operating condition, it is having nothing

added to the value of the plant, it is not a rebuilding or a substitution of new material for old material in the plant, it is simply keeping the plant in an operating condition, such as tightening up wires and other things necessary to keep the plant in a high state of efficiency from an operating standpoint. When the wires are tightened, nothing additional is being added to the plant, and new wire is not substituted for the old wire, but the old wire is simply tightened up so that it can be used in operating the plant.

A homely illustration may be used. A vehicle is maintained in running condition by being washed and greased, but this is not depreciation—it is not substituting any new part of the vehicle for a part which has served its life, worn out and must be renewed. It is simply keeping the vehicle in an operating condition, and so it is when a bolt or nut becomes loosened, and is tightened up. This expense is ordinary repair, or maintenance repair; but when a wheel breaks down and a new one is substituted, this is replacing a part of the vehicle with a new part, and this new part replaced is a charge to reconstruction or depreciation.

So that Complainant insists that the Master is in error in assuming that maintenance is included in the seven per cent allowance for depreciation.

Mr. Polk, in his second deposition, in speaking upon this subject, states that there are two kinds of maintenance—one is called "maintenance of operation," and the other "maintenance of plant."

Trans., p. 1419.

And on page 1419 of the Trans., he states, in figuring the expense of conducting a telephone exchange, that he would allow \$40,000 to \$45,000, "say \$45,000," for maintenance.

And then, on page 1419 of the Trans., he says that he would allow 5 per cent of the physical value of the plant for depreciation, and that he would *not* charge maintenance to this depreciation account.

The Master quotes from the decision of the Supreme Court in *Knoxville vs. Waterworks*, 212 U. S., p. 14, where it is said:

"Before coming to the question of profit at all, the company is entitled to earn a sufficient sum annually to provide not only for current repairs, but for making good the depreciation, and replacing the parts of the property when they come to the end of their life."

Notwithstanding the fact that the Master quotes this language, he still insists that *current repairs* must be included in depreciation, while Complainant insists that the language of the Court is as plain as can be written, that current repairs and depreciation are wholly separate and distinct things.

Complainant, therefore, insists that the Master has erroneously included current repairs, or maintenance, in depreciation.

Probably the best analysis of the way depreciation of a telephone plant is ascertained is shown in the report of the committee to the Chicago Council, where the Telephone Commission states what the depreciation per annum on the different items of a plant will be, in their judgment, in the City of Chicago (see Trans., p. 831).

The commission first ascertained what they believed to be the life of each particular item composing the entire telephone plant. They gave the life of underground conduit as being fifty years; underground cable, twenty years; poles, including cross-arms, ten years; subscribers' station instruments, ten years; private branch exchange switchboards, eight years; fireproof buildings, forty years; teams, tools, furniture, etc., four years, and so on throughout the entire list of every item of material entering into a telephone plant.

Having ascertained the life in years of each particular part of the material in the plant, they next ascertained the original cost of each particular part, and then ascertained the per cent to depreciation. In this way they ascertained that underground conduit only depreciates .89 per cent of its original cost per annum; they ascertained that underground cable will depreciate only 3.72 per cent of its value per annum; that aerial cable will depreciate 5.38 per cent of its original value per annum; that subscribers' station instruments will depreciate 8.73 per cent of its original cost per annum; and that teams, tools, furniture, etc., will depreciate 23.92

per cent of their cost per annum. And so on with the other items composing the plant. In this way they arrived at how much each item in the plant will depreciate per annum, and by taking the *average* per annum, based upon the value in dollars of each, the commission ascertained that a telephone plant will depreciate 8.03 per cent of the original cost per annum; and, therefore, the commission sets aside 8.03 per cent of the original cost of the plant per annum for depreciation. This includes everything connected with the plant except supplies and working capital, but *does* include the fire-proof buildings.

The basis insisted upon by Complainant is that seven and one-half per cent of the original cost of the plant should be set aside each year for the depreciation fund, and that this seven and one-half per cent of the original cost of the plant must be taken out of gross earnings before there can be any net profits, but in reaching the cost of the plant there is excluded working capital, supplies and material on hand, and real estate and buildings, which leaves the bare plant, and it is only seven and one-half per cent of the bare plant that is considered by Complainant in determining the depreciation fund.

In view of the fact that a telephone plant is deteriorating all the time, and in view of the fact that after the plant has been in existence some years, that different parts of the plant require renewing each year, the process of reconstruction or caring for depreciation is going on continuously, and whatever amount is expended in replacing any part of the plant that has worn out or reached the end of its life, either through decay, wear and tear, or the invention of something which takes the place of that part of the plant, is charged on the books as "reconstruction," and this amount is deducted from the seven and one-half per cent depreciation fund, because it is *pro tanto* taking care of depreciation, leaving the difference between seven and one-half per cent of the cost of the bare plant, and the amount actually expended during that year in re-construction, as the balance to be set aside out of earnings to take care of incomplete depreciation. This incomplete depreciation may arise from several causes, and it does not come evenly

year in and year out, but *does* come in a cycle of time. A telephone plant may escape the necessity for the incomplete depreciation for a number of years, inventions of apparatus or new methods of making cables, or new subscribers' station equipment, or other parts of the plant, are not discovered with regularity, but at intervals of time; disasters, which experience has taught owners and operators of telephone plants, are certain to come in one form or another in a cycle of time. When these inventions or disasters *do* come, then it is not merely seven and one-half per cent of the original cost of the plant that is needed to replace part of the plant, but it is often many times seven and one-half per cent.

And so it is that not only in the telephone business, but in every business where material, machinery, apparatus and appliances are being used, this risk and expense of the business must be taken into consideration, and provided against in order to prevent disaster to the enterprise.

Complainant does not contend that any part of the gross earnings of one year should be set apart to care for incomplete depreciation occurring in preceding years. It only asks that each particular year shall bear its proportion of the annual contribution to this depreciation fund. Complainant does not ask that the expenses of 1908 be burdened with any part of the depreciation which will occur in 1909. But does ask that 1908 be required to bear its proportion of the annual contribution to the depreciation fund.

The fact that Complainant has not in the past set aside as a sacred trust fund a part of its gross receipts from its Louisville plant to care for incomplete depreciation, when the time comes for such expenditure to be made, does not affect the principle it contends for—that is, that each year should be burdened with its proportionate amount, as a contribution to this fund.

In the process of its business Complainant may be compelled to provide this fund for incomplete depreciation from its other properties, from its reserve accounts, from its surplus, from borrowed money, or from the sale of securities. Whether this fund be pro-

vided in one way or another does not concern any one else than Complainant and its shareholders.

This record shows that since 1902 this Complainant has had active and untiring competition to meet, in operating its plant in Louisville.

So that the theory that Complainant *ought* to exact from its patrons a sufficient amount each year to pay all of its operating expenses, all of its current repairs, and provide a sufficient depreciation fund to care for the property when the time comes for its renewal, and over and above all these expenses, to yield to Complainant a fair and adequate return upon its investment is an ideal condition, that can only be approximated according to conditions over which Complainant neither has nor can have control.

The laws under which it is created expressly forbid that it shall either consolidate with or purchase its rival in business. The law demands that Complainant shall to the end exist under conditions which render it utterly impossible for it to obtain a fair reward for the service it renders. It is not a theory, but a condition that confronts it in the conduct of its business in the City of Louisville, and this record abundantly shows it.

The Master, on page 142, after stating that he is satisfied that a fund to cover depreciation of plant is necessary, and that this fund should come out of earnings, states that because different parts of the plant last longer than other parts, and because the percentage of depreciation on different parts of the plant and property is not subject to a general law or rule, states:

"To establish an average is beyond my power, as the evidence does not aid me in this regard."

Complainant excepts to this part of the report of the Master, and insists that the record does show what amount is necessary and proper within a reasonable degree of accuracy that is necessary to be set aside for the depreciation fund.

Complainant's President, who has been engaged in the business for twenty-five consecutive years, says that:

"It will not be found very far from ten per cent. It might be something under that, and it might be something more, but between seven and a half per cent and ten per cent is, in all likelihood, the amount that will be found necessary, and these estimates will necessarily vary, and will be varied from time to time as experience is gained."

Trans., p. 511.

Mr. Hume, the General Manager of Complainant, who has devoted at least twenty-five consecutive years to the telephone business, over an area one thousand miles long and four hundred miles wide, comprising a system of exchanges and toll lines, says that "the proper depreciation is from seven to seven and one-half per cent of the cost of the plant."

Trans., p. 671.

He states:

"Well, that is a matter and a feature of the business that has called for the closest study and attention on the part of the best operating men and the best engineers that could be gotten hold of, I mean, that question of depreciation as applied to telephone properties generally. The same general conditions that govern one in reaching conclusions at one place, enter into consideration at another, but the same results are seldom found, because the conditions confronting a plant in one city are, for the most part, so radically different from the conditions that confront the same kind of a plant in a different city. In the Cumberland Telephone & Telegraph Company's system that has been markedly true, because our lines run from up in Indiana and Illinois clear on through to the gulf coast country, but speaking of our experience in Louisville, a ten-year term, and during that time a great deal of the property having been put there as brand new property, you can only judge by your experience generally, and by the condition of the plant you had ten years ago, and the relative condition of property that has been put in during that time, these succeeding nine, eight or six years and on down to the present, but taking all of that into account, I am sure that the percentage

we are working on is as small as we could dare take with any degree of safety, that is seven or seven and one-half per cent."

Mr. Crumb, a telephone engineer, introduced as a witness for Defendant, states that seven per cent of the cost of the plant is proper for depreciation, and this does not include maintenance repairs.

Trans., p. 904.

Mr. Levings, another witness introduced on behalf of Defendant, states that telephone engineers differ as to the amount of depreciation that should be set aside—that the per cent of the cost of the plant ranges from twelve to fifteen per cent, and when asked to explain what he means by this, says:

"I meant by that expression that there are two ways of considering what is commonly termed depreciation. These two ways are subjects of argument among all engineers, and one way of arriving at a depreciation figure includes certain expenses which other engineers include as maintenance charges. When such a procedure is followed, the depreciation charge naturally is increased over that which is used by an engineer who does not include this disputed maintenance charge. Therefore, I say that some engineers calculate their depreciation with this disputed factor, while I do not."

Trans., p. 1542.

Mr. Levings thinks that in Louisville a depreciation charge of five per cent per annum on the cost of the plant would be sufficient.

Trans., p. 1534.

Mr. Polk, a telephone engineer, was a witness for the Defendant, and says:

"I would set aside (for) the depreciation account practically five per cent of the physical material—physical value. I have set aside fifty thousand dollars a year, and any renewals made I would charge against that account."

Trans., p. 1419.

He further states that *it is at last a mere matter of each man's individual opinion of what is sufficient; that engineers differ; that the man*

who has best knowledge of what is necessary is the general manager of the company.

Trans., p. 1420.

H. Blair Smith, Auditor of Complainant, who has been such for more than ten years, who has of necessity a ripe experience in determining the life of telephone properties, and who, of necessity, has an intimate acquaintance with the cost and method of operating the Louisville plant for the past ten years, states that from his experience in the telephone business, he believes that a depreciation of seven and one-half per cent on the cost of the plant is justifiable.

Trans., p. 228.

He also states the difference between depreciation and maintenance to be:

"Maintenance is simply the repair of the property.

Yes, repairing troubles, replacing lines that are blown down, adjusting instruments and replacing light repairs like cords on telephones, and cords of switchboards, resoldering connections, replacing micas and fuses that are burned out and things of that kind.

Maintenance is simply the keeping in repair of the property; and reconstruction is caused on account of depreciation, and is a replacement of the property which is no longer serviceable or must be discarded on account of having become useless, because of newer inventions."

He further states that:

"Depreciation is the natural wear and tear that occurs to everything that is exposed, everything except the ground. Depreciation in telephony is the depreciation, or rather the antiquation of the plant, as well as its decay."

Trans., p. 228.

This witness also sets out in great detail the different things that are included under each heading of expense. These headings of expense show clearly the difference between maintenance and maintenance reconstruction, and it is made clear that this *is* a difference between the two accounts.

Trans., pp. 214 and 215.

There is no evidence in this record which in the slightest degree contradicts or varies what has hereinabove been shown to have been said upon this subject.

The Master, on page 143, says:

"It may be mentioned in passing that during January, February and to the 6th of March, 1909, Complainant spent only \$491.65 for maintenance and reconstruction. This fact may fairly be accounted for by assuming that no great outlay was required for such purpose."

In this, the Master has, by inadvertence, misstated the fact. It clearly appears that the item of \$491.65 was not for maintenance or reconstruction, but was construction.

Trans., pp. 1051 and 762.

Complainant tendered to the Master the financial operation of the Louisville plant for the whole year 1909, and offered to go into the experience of Complainant with the plant during that year, but the Master stated:

"Right now I am not able to say whether that would be important or not. When we get through with the proof, if we want it, I will take it myself. I will just order that myself."

Counsel for Complainant:

"I merely make the tender so it cannot be said later that we did not bring these things down to date."

The Master:

"I think we had better defer that for the present."

Trans., p. 691.

For these reasons, Complainant insists that while the Master correctly reported that seven per cent per annum of the bare cost of the plant was a proper amount to allow for depreciation, his application of the depreciation fund is entirely erroneous, and to his method of the treatment of the depreciation fund Complainant excepts.

THE MASTER'S REPORT.

VI.

"He will ascertain and report whether the reasonably probable increase from Complainant's plant and property employed in its business in said city will, within the next few years, amount to a fair annual return upon the reasonable value thereof if the provisions of the ordinance approved March 6, 1909, are put into operation."

I have heretofore found the value of Complainant's plant, the gross and net earnings for 1905, 1906, 1907 and 1908, and the total operating expenses for each of said years, and the percentage of net earnings to the reasonable value of Complainant's plant. I have found what will be a proper allowance each year for depreciation of plant, and I have found what will be the probable net loss to Complainant the first year and second year, should the ordinance rates be enforced; and, basing my calculation on what I find to be the net earnings of 1908, and assuming that the earnings are the same in 1909 and 1910 as they were in 1908, and assuming further that the probable value of the plant in 1911 will be increased from \$1,351,878.09 to \$1,400,000.00, I find that the probable net income of Complainant

For 1911 will be.....	\$ 120,673.19
Which would be.....	8.60 per cent

of the then value of the plant.

I have found that in 1912 it is probable that the net earnings of the plant under ordinance rates will be equal to the net earnings in 1908 under operation of the present rates. The net earnings would then be ten per cent on a valuation of \$1,500,000.00.

My reasons for so finding are, that the increase in the number of subscribers in 1911 and 1912, should the ordinance rates be enforced, will be large, and that the increase in net earnings thereby will more than offset the loss of earnings that will be caused by the lowering of rates.

I answer the sixth question, therefore, by saying that in my opinion the reasonably probable income from Complainant's plant and property employed in its business in said city will, within the next few years, amount to a fair annual return upon the reasonable value thereof, if the provisions of the ordinance approved March 6, 1909, are put into operation.

EXCEPTIONS OF APPELLEE.

The Master states that, after having as heretofore stated, found the value of Complainant's plant, the gross and net earnings for 1905, 1906, 1907 and 1908, the percentage of net earnings to the reasonable value of the plant, and a proper allowance each year for depreciation of plant, and probable net loss to Complainant the first and second year, should the ordinance rates be enforced, and basing his calculations *upon all these things*, and further *assuming* that the probable value of the plant in 1911 will only be increased less than \$50,000, the probable net income of Complainant for 1911 will be at the rate of 8.60 per cent of the then value of the property.

He further finds that in 1912 the net return will probably be ten per cent upon this same value, which he assumes he has found for the year 1910.

The Master states:

"My reasons for so finding are that the increase in the number of subscribers in 1911 and 1912, should the ordinance rates be enforced, will be large, and that the increase in net earnings thereby will more than offset the loss of earnings that will be caused by the lowering of rates."

Supra p. 155.

Complainant excepts to this finding of the Master, because it is based upon an erroneous assumption of facts, and fails to take into consideration the inherent and essential features of the telephone business.

As has heretofore been pointed out in these exceptions, the Master has proceeded upon a fundamentally erroneous theory of the telephone business. He has failed to take into consideration the fact that as

the subscribers increase, the cost of the plant increases correspondingly.

Trans., pp. 512, 513, 514 and 1434, 1435 and 1436.

Mr. Caldwell says:

"Well, if you increase your subscribers you would be compelled to increase your facilities, and your capital account. You would be compelled to increase your operating force to take care of the greater number of calls that would go over the system; you would have to encounter certainly a shifting of customers from one class of rates to another, which expense you would be certain to meet, but you do not know what it would be. The growth that would take place in that, you could not tell whether it would be on the maximum or minimum, or in what direction in the city it would be found; it would all be a matter of speculation, so that to forecast the future on that, is a matter of speculation and doubt."

Trans., p. 512.

The Master has failed to take into consideration the fact that as the number of subscribers increase the expense of conducting the business per subscriber increases.

Trans., pp. 699 and 1439.

As was tersely stated by the Chicago Commission:

"It is a tradition in telephone circles that the service per telephone costs more as the number of telephones connected with the plant increases, as the number of telephones increases, each subscriber has the opportunity to call upon more people by telephone, and the law of averages would indicate that the number of calls per day from each telephone should increase, thus making the service more expensive to the operating company, provided the service is flat rate service and unnecessary use of the telephone is not deterred by a measured rate charge. This condition seems to have worked out in practice, according to the statements of telephone companies at Cleveland, Indianapolis, and elsewhere, and flat rate service seems to increase in cost per telephone as the number of telephones attached to a system increases."

Trans., p. 826.

There is one witness in the record who has had actual experience in dealing with telephone rates in the City of Louisville, whose testimony is of more service in solving this problem than the theories and opinions of witnesses who have not had experience, however skilled they may be.

Mr. Caldwell, the Complainant's President, says:

"We have tried and experimented with every conceivable class and kind of rates and every theory of rating that those that were best qualified to talk on the subject, have suggested, we have tried, and our experience there was that every one of them proved disastrous, disappointing and a failure. In other words, we had poorer results, until this last series of rates which we inaugurated some two years ago—they show a betterment of conditions, the others all showed worse, so that it was not a matter of theory, but it has been a matter of actual experience with us in the City of Louisville."

Trans., p. 513.

Experience gained in operating a plant under certain rates is the only safe guide to follow in forecasting the future upon different rates.

La. R. R. Com. vs. Telephone Co., 212 U. S., 426.

Mr. Polk states that it is a *mere gamble* as to whether the rates prescribed in the ordinance are remunerative *even* in a plant *only* costing \$1,300,000, including real estate.

Trans., pp. 1439-40.

If, therefore, the value of the plant be added to so as to make its value \$1,500,000, and the increased patronage entails a greater expense per subscriber, it is manifest that the net profit would be less on a plant costing \$1,400,000 (as the Master assumes it will be—Trans., p. 155) than a plant costing \$1,300,000.

For these reasons Complainant excepts to this part of the Master's report, and insists that it is based upon an incorrect theory of the telephone business.

The Master should have reported that the certain result of enforcing the rates prescribed in the ordinance would spell disaster, and the more rapid the growth of the exchange the sooner would disaster overtake it.

THE MASTER'S REPORT.

VII.

"He will, from the testimony, ascertain and report whether the average net income or return from reasonably safe investments in business enterprises in said city approximately resembling that of Complainant, is above or below six per cent upon the reasonable value of the plant or property from which said income is derived."

The evidence adduced in this question shows that there is only one telephone company doing business in the City of Louisville besides Complainant, that is the Home Telephone Company. Its stock and bonds were mainly given to the contractors who built the plant. Some of the bonds and some of the stock were sold to the public. The company has paid four dividends of one per cent each within a given period of eighteen months. It has paid no dividends recently. Its stock has no market value, and its five per cent bonds in the latter part of 1909 were offered at \$69.75, but there were few purchasers.

The Louisville Gas Company pays five per cent dividends on its capital stock, and its shares sell at about \$95.00. It earns about seven per cent on the money invested.

The Kentucky Heating Company pays three per cent dividends on its common stock and five per cent on its preferred stock. Its common stock, in 1909, was worth, on the market, about \$64.00, and its preferred stock \$90.00.

The Louisville Lighting Company paid four per cent dividends for four or five years.

The Louisville Traction Company pays four per cent dividends on its common stock, and its market value, in 1909, was \$94.00 and its highest price was \$147.00. It earns a fraction under five per cent on its common stock.

The Bank of Kentucky pays eight per cent dividends and usually adds to its surplus fund every year.

The Union National Bank pays ten per cent dividends and adds to its surplus fund every year.

In 1909 the Fidelity Trust Company paid twelve per cent dividend.

It may be permissible to classify all public utility companies—as traction companies, water companies, gas companies and lighting companies—with telephone companies. It is doubtful whether banks should be placed in such a class. But certainly manufacturing and industrial companies are not in the same class with telephone companies.

But, it is insisted that unusual risks and hazards attend the telephone business, and that on account of these hazards, a greater return on the money invested should be permitted by the rate-regulating powers. It is urged that new capital must be continually put into this business, so that its lines and operations may be commensurate with the growth of the cities where they are located; that otherwise, the business must come to a standstill, and new companies will enter the field and take the new business offered and perhaps the old business. It is urged that eight per cent or perhaps ten per cent on the money invested would, therefore, be a fair return.

For the reasons given in my answers to former questions, I find that the average net income, or return, from reasonably safe investments in business enterprises in Louisville approximately resembling that of Complainant, is below six per cent upon the reasonable value of the plant or property from which said income is derived.

If banks should be included in the same class with telephone companies, then I find that the net average income of all such companies is above six per cent per annum in Louisville.



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EXCEPTIONS OF APPELLEE.

The Master reports that Louisville Home Telephone Company five per cent bonds are selling on a basis of \$69.75; the Louisville Gas Company's five per cent dividend-paying stock sells for \$95.00 a share; Kentucky Heating Company's five per cent preferred stock sells at \$90.00; Louisville Traction Company's four per cent dividend stock at \$94.00; Bank of Kentucky pays eight per cent, and usually adds to its surplus fund annually; the Union National Bank pays ten per cent dividends, and adds to its surplus account; the Fidelity Trust Company in 1909 paid twelve per cent.

The Master then states:

"It may be permissible to classify all public utility companies—such as traction companies, water companies, gas companies and lighting companies—with telephone companies. It is doubtful whether banks should be placed in such a class, but certainly manufacturing and industrial companies are not in the same class with telephone companies."

Supra p. 161.

Complainant excepts to the statement of the Master in stating that the owner of a telephone property is not entitled to the same rate of return on the value of its plant that is received by banks, manufacturing and industrial concerns.

It is apparent from the evidence that there are no greater risks in banks, industrial or manufacturing concerns than is in the telephone business, and it appears from the Master's report on this branch of the case that while a five per cent dividend paying stock of a gas company sells for \$95.00, and a traction stock paying a four per cent dividend sells for \$94.00, a five per cent telephone bond only sells for \$69.75.

The Master further states:

te. "But, it is insisted that unusual risks and hazards at-
haz d the telephone business, and that on account of these
urds a greater return on the money invested should be

permitted by the rate-regulating powers. It is urged that new capital must be continually put into this business, so that its lines and operations may be commensurate with the growth of the cities where they are located; that otherwise, the business must come to a standstill, and new companies will enter the field and take the new business offered and perhaps the old business. It is urged that eight per cent, or perhaps ten per cent, on the money invested would, therefore, be a fair return."

The Master then finds that the average net income or return from reasonably safe investments in business enterprises in Louisville approximately resembling that of Complainant, is below six per cent upon the reasonable value of the plant or property; and that if banks be included with telephone companies, the net average income is a little above six per cent.

Complainant excepts to this part of the report of the Master, and insists that he should have reported that a telephone investment is entitled to ten per cent net return upon the actual investment.

It is shown in the record that as a telephone plant increases its patrons it must increase its capital account, and in order to increase its capital account it must sell its securities, and in order to sell its securities it must show an earning power sufficient to attract new capital to the business.

Mr. Caldwell states a telephone property is successfully financed as follows:

"By an increase from time to time, of its capital stock, has been found the only practical way. Where bond issues have been resorted to, one issue clouds and interferes with subsequent issues, but where additional shares of stock are made and they all stand on the same basis, as they do stand on the same basis, the one issue does not take precedence over or destroy the standing of the next issue, but on the contrary they rather have a tendency to aid each other, and hence that has been found to be the most practicable and satisfactory, and, I may say, the only practical way to finance a telephone system."

Trans., pp. 513-514.

He further states that there must be additional capital invested in the business from time to time to meet the growth of the business.

"The growth is continued and continuing; it is no let up, but on the contrary continues to grow, and unless the company meets this growth, its usefulness becomes impaired or lessened, and it at once is on the down grade instead of the up grade. It must go forward continuously, it must meet the public requirements, and to do this it must have continuously additional capital."

When asked what effect the earnings have upon its ability to increase its capital account, he states:

"The whole question comes right there. Unless the company is on a profitable basis, and is doing a business that is profitable, it has no credit, and it is necessary for it to have credit. Therefore, in order to attract new capital, it must present sufficiently attractive profits to cause people to put their investments in the telephone business rather than in some other line of business, and, of course, unless it can show a profit in its business, it cannot possibly influence or attract capital to it. That is the key to the whole financial problem."

And he states that the net profit on a telephone property ought to be an actual cash return on its investment of ten per cent.

Trans., p. 514.

Mr. Polk thoroughly sustains all that Mr. Caldwell says upon this subject. He states that the construction account must be increased year by year; that to get new capital a sufficient return must be shown to attract new investors, and that a telephone property is entitled to *at least* ten per cent net profit.

Trans., p. 1436-7.

The Chicago committee recommended, and the Council approved, a net return to the Chicago Telephone Company of ten per cent.

Mr. Levings says that he does not know any one who has money

to invest in a telephone plant that will not promise *at least* eight per cent profit. He is then asked this question:

"Do you regard 8 per cent as a fairly reasonable profit for a man to make on his telephone investment?"

A. I should say so."

Trans., p. 1539.

A committee of the New Orleans Board of Trade, in investigating telephone conditions in that city, recommended that the company be permitted to earn a net return of ten per cent on its investment, and quoted with approval the following taken from the telephone report of the Merchants' Association of New York having under consideration what constituted a reasonable margin of profit for a telephone company. The report says:

"The telephone business demands a continuous accession of fresh capital to satisfactorily serve the public. Having in view the importance to the public of constant improvement and expansion and the greatest possible efficiency of telephone service, as well as the necessity of offering an attractive investment to new capital to provide for such expansion, it is the opinion of this committee that to provide a fair return on capital actually and necessarily invested and a proper allowance for contingencies, 10 per cent margin above operating outlays is a reasonable and proper margin in the telephone business. In the various movements hitherto made for the limitation by law of telephone profits, wherever the permissible percentage of profit has been dealt with, this margin has been accepted as a proper one. It has also been specified by law in the case of some other public service corporations."

Telephone Conditions in New Orleans, Trans., p. 495.

Mr. Polk, in his second deposition, states that a telephone company is entitled to a greater return than a steam or street railroad. He states:

"Corporations have different ways of figuring. Street railways, steam railroads, figure five per cent as a safe return. Of course, a concern like a telephone company, I should consider as more than a fixed railroad, because the nature of its business fluctuates, and there are more risks than would be on a trunk

line of railroad, and I would say it would have a higher return than a trunk line railroad."

He then says:

"I said I do not think it should be less than 10 per cent."

Trans., p. 1437.

Complainant, therefore, excepts to the report of the Master on this branch of the case, and insists that he should have reported: That Complainant is entitled to earn per annum ten per cent net upon its plant in the City of Louisville.

THE MASTER'S REPORT.

VIII.

"He will further ascertain and report from the testimony whether the reasonably probable net income of Complainant from its plant and property employed in its business in said city, after making all proper allowances for cost of operation, claims for damages, repairs and depreciation, would, during the years 1909 and 1910, come up to or exceed the said average income upon such other business enterprises if said ordinance should be put into operation, and he will state in his report the results of his estimates and the basis thereof."

For the reasons contained in my report supra, I find from the testimony that the reasonably probable net income of Complainant from its plant and property employed in its business in Louisville, after making all proper allowances for cost of operation, claims for damages, repairs and depreciation, would, during the years 1911 and 1912, exceed the average net income upon such other business enterprises if the ordinance of March 6, 1909, should be put into operation.

My answer to the 7th question supra contains the basis of my answer to the 8th question.

EXCEPTIONS OF APPELLEE.

The Master states under this heading that his answer to the seventh question is the basis of his answer to this question.

Therefore, Complainant excepts to the report of the Master under this heading for the reasons stated in its exceptions to the Master's report under the seventh heading.

THE MASTER'S REPORT.

IX.

"He will also, from the testimony, report his conclusions and the basis thereof as to the reasonably probable extension and increase of the Complainant's business in said city within the present and next succeeding year, and the reasonably probable extent and effect thereof both upon its gross and upon its net income."

The evidence shows that the Complainant Company has thus far constructed its plant with a view to and with the expectation of a substantial increase in the number of subscribers. This policy, under the evidence, I find is wise and prudent, and ought to be approved. The business centers are not apt to be changed. They are generally stable and practically permanent. On the other hand, the residence centers frequently change, and this necessitates a change in telephone lines, and a prudent company will construct its plant so as to be prepared for such changes.

Complainant has laid its conduit system and erected its pole lines and properly equipped same so as to be in a position to take care of more than two thousand new subscribers without delay. The existence of such surplus plant has been criticised by Defendant's experts—not as to the fact of said surplus, but only as to its extent. But I am of the opinion that such surplus as is shown and as stated above, is not unwise or improper.

Should the ordinance rates be enforced, the wisdom of Complainant's foresight in providing its surplus plant will be amply justified.

I do not doubt that by the lowering of the company's rates, independently of the natural growth of its plant, the number of subscribers will be largely increased, and such increase will begin immediately after the lower rates are put into operation. There is no evidence as to whether the number of subscribers has increased naturally or decreased since March 6, 1909. I assume that there has not been any substantial decrease. I have already stated that I think an increase

in the number of subscribers will be remunerative to Complainant. The fact that surplus plant already exists sufficient to take care of more than two thousand new subscribers, removes any doubt on this subject that may have existed. The probable extent of such increase in the number of subscribers, as well as the increase in net earnings to be caused thereby, is problematical. But, considering the statements of all the witnesses, I am of the opinion that if the lower rates should be enforced in 1911, that by the end of 1912, the probable loss in revenue of about \$49,000.00, would not only be wiped out, but a substantial increase in net earnings would result, without a corresponding increase in expenditures.

The main increase in subscribers may naturally be expected in the residential sections of the city, as well as in the suburban districts, where much of the surplus pole lines already exist. In the business sections, I take it, there will be smaller increases. If my hypothesis be justified by the actual results, that is, that the main increase will be in the residence 'phones, the evidence shows that there will be a less frequent use of such new instruments than there would be of new 'phones in business houses, and consequently the extra help as to operators would probably not be as large as if the main increase in subscribers were in business houses.

I am, by no means, satisfied from the evidence, that the increase in the number of subscribers will, on an average, increase the cost of operation per telephone or station. In other words, if the company now has nine thousand subscribers, and two thousand additional subscribers be taken on, I do not believe that the cost per station for eleven thousand subscribers will be as great as it is for nine thousand subscribers.

I find, under all the evidence, that the necessary result of an increase in the number of subscribers will be an increase in the gross revenues of Complainant in the next two years; and further, that the net revenues will also be increased, and that this ratio of increase will be continuous.

EXCEPTIONS OF APPELLEE.

The Master, under this heading, states:

"The evidence shows that the Complainant company has thus far constructed its plant with a view to and with the expectation of a substantial increase in the number of subscribers. This policy, under the evidence, I find is wise and prudent, and ought to be approved. The business centers are not apt to be changed. They are generally stable and practically permanent. On the other hand, the residence centers frequently change, and this necessitates a change in telephone lines, and a prudent company will construct its plant so as to be prepared for such changes."

Supra., p. 168.

The Master also states that Complainant has laid its conduit system and erected its pole lines and equipped the same so as to be in a position to take care of two thousand new subscribers without delay, and this the Master commends as being wise and proper, but adds: "Should the ordinance rates be enforced, the wisdom of Complainant's foresight in providing its surplus plant will be amply justified."

The Master then states that a lowering of Complainant's rates, independently of the natural growth of the plant, will largely increase the number of subscribers, and that such increase will begin immediately after the lower rates are put into effect.

The Master then adds: "The probable extent of such increase in the number of subscribers, as well as the increase in net earnings to be caused thereby, is problematical. But, considering the statement of the witnesses I am of the opinion that if the lower rates should be enforced in 1911, that by the end of 1912 the probable loss in revenue of about \$49,000.00 would not only be wiped out, but a substantial increase in net earnings would result, without a corresponding increase in expenditures."

Complainant excepts to this part of the report of the Master, because the evidence shows that surplus facilities are necessary in every

plant, and there must be at all times kept a surplus of facilities to take care of new patrons, and because the Master assumes that increased patronage will not increase expenses and capital account.

In reply to a question as to whether or not it is necessary and proper that new business be anticipated, and facilities provided prior to the offering of new business, Mr. Caldwell says:

"Yes, for the reason that it requires quite a length of time to provide additional facilities on an exchange and the customers could not be expected to wait so long a time for the service; hence, it is not only necessary but it is practiced in all companies which expect to meet the public requirements, to keep a certain surplus reserve of facilities always on hand, and as they are used up, to provide others, so that they will be able to meet the demands promptly, and any other method would leave the service open to very grave criticism and reflection, for the old customers have an interest in having new ones connected, have an interest quite as important as the new customer, for every new customer gives an additional value and opportunity to all the old subscribers.

Q. What would be the result, practically, if the company should not provide facilities for future growth before such new business was offered, but should wait until the new business was offered before undertaking to provide the facilities necessary to serve the new patrons?

A. Well, as it would often require a year in which to provide additional facilities, it is quite plain what a disappointment it would be and how far short a company would fall of meeting the public requirements, for the customers usually desire the service at once, and certainly could not be expected to wait longer than a very few days. They rather expect to have the facilities supplied to them within twenty-four or thirty-six hours, and they have been accustomed to that so long, that it is now recognized as a fixed condition. If, therefore, conditions should arise that would make delay in providing service longer than this, the company would be considered as wholly inadequate, and indeed, open to the criticism of being a rather poor affair."

Trans., pp. 506-507.

There is no witness in this record who contradicts or varies this

statement in the slightest degree; indeed, the statement itself is so entirely reasonable and self-evident that we apprehend no intelligent witness could deny it.

If, however, this surplus of facilities *should* be used in supplying the additional patrons to be obtained under the ordinance rates, Complainant would have to provide *additional* surplus facilities to accommodate the new subscribers to be obtained on the normal growth of the city, unless it be assumed that Louisville is to stop growing and become a finished city, which no one will admit.

The evidence is that there must be *at all times* a surplus of facilities.

But the Master assumes that the Complainant will find this new patronage at the exact points where the surplus facilities are, and at the same time he says that the new business to be expected will naturally be in the residential sections of the city, as well as in the suburban districts, and that in the business districts there will be smaller increases.

The Master overlooks the evidence on this subject. Mr. Polk states that the surplus cable that he is speaking of exists in the conduits, which, of course, are in the central business portion of the city and not in the suburban or residential sections.

Trans., p. 1447.

But in another place, says the cable system covers the entire city.

Trans., p. 1448.

Just what he does mean is left in doubt. But Mr. Caldwell says there is no such surplus cable facilities, and adds:

"We carry and aim to carry a certain excess service to take care of customers, as they would come in the ordinary growth, and I do know that we have some surplus here. It might be that we would have that amount of surplus in some conduit space. We might have it in buildings. We

might have adequate space in our buildings, and, as I say, in the conduits, but to say that we have that as a complete equipment, ready to take on those customers, that would not be true."

Trans., p. 836.

Mr. Polk was asked to state what would be the additional expense per subscriber if Complainant obtained eight thousand more subscribers at the points where the cables are; and he said, twenty to twenty-five dollars per station; "that is, if the subscribers are right where they can be served so that it would take nothing but the drop to make the installation."

Trans., p. 1449.

What the witness means by the "drop" is the drop wire from the pole or cable to the residence, or business man's house, interior wiring, instrument and the labor and expense of installing it.

But Mr. Polk did not mean to say that this was all the capital that the company would have to expend in obtaining additional subscribers.

Thereafter, in reply to an inquiry as to what new capital would be required to install eight thousand additional subscribers, he states:

"The question, the way it was put to me, as I understand it, was, assuming that there would be no expense except that of running the drop and installing the telephone at the subscriber's station, what would it cost per station to add eight thousand telephones, and I stated, assuming that those were to be the only expenses, it would cost about \$25.00 per line.

Q. What other costs would there be in connection with installing 8,000 new subscribers here in Louisville?

A. The cost would be increased in the switchboards, increased in the trunking facilities between the offices—if 8,000 additional subscribers were added, of course, it would be unreasonable to assume there would be no expense at the outer end; there would have to be a certain number of additional cross-arms put on, a certain number of additional insulators, and a certain amount of aerial wire strung; so

the assumption, of course, is an impossible condition that wouldn't exist."

Trans., p. 1451.

And he again states:

"At the present time the switchboard is valued at \$203,000, approximately; 10,000 line equipment would make the present average cost of switchboard for one line twenty dollars and a fraction. In order to place 8,000 more subscribers to the system, they would have to have at least 4,000 additional switchboard capacity average, and as these switchboards grow, being of a multiple character, the cost per line will increase; so it is reasonable to assume that these 4,000 additional lines would cost at least \$22.00 per average. That would make an additional expense of 22x4,000, which would be \$88,000 for switchboards alone. Also, for the expense at the outer end; stringing what additional aerial wire might be necessary, putting on additional cross-arms, and insulators, we will say, \$5.00 a station, 8,000 would make an additional of \$40,000 expense. I figure that this would probably be a reasonable additional expense assuming that the cable facilities were ample."

Trans., p. 1451.

So that adding the \$25.00 per station, as above stated, amounting to \$200,000, to the \$40,000 and the \$88,000, makes the additional construction account expense \$328,000.

But the Master also says that the additional subscribers would come largely from the residential and suburban section of the city. Of course, this means more expense in equipping and serving these patrons than would be the expense of equipping and serving a like number of patrons in the business districts of the city, because it means longer wires, further distances for troublemen and other employes to go to repair telephones and wires, and other expenses necessarily entailed in operating the plant.

This would also mean that the growth of the plant would be upon the cheap rates, and not upon the high rates—that is to say, the growth would be largely upon the residence rates and not upon

the business rates. The great reduction in the rate ordinance comes on the business rate, and not on the residence rate. On the business rate it is \$2.00, and on the residence rate it is only \$0.50 per month. It is shown that there are 730 patrons in Louisville paying the maximum business rate of \$7.50 (which the ordinance reduces to \$5.50 per month), and there are 875 now paying the maximum residence rate of \$3.50 (which the ordinance reduces to \$3.00 per month).

Trans., p. 225.

The immediate effect of putting into effect the ordinance rates would be a reduction of \$2.00 a month on each of the 730 business telephones, amounting to \$17,520.00 per annum, and the reduction in the residence rate would only amount to \$5,250.00 per annum; so that in order to overcome the loss in business telephones of \$17,520.00 per annum an enormous number of residence telephones would have to be installed at even the maximum residence rate of \$3.00; and if we assume that the residence rate of \$3.00 only yields a fair profit to Complainant, then Complainant could not install enough residence telephones to offset the loss in revenue from the business telephones, because there could not be anything more than a fair profit on the residence telephones at \$3.00 per month, regardless of the number installed.

It must be remembered that Complainant's witnesses say that the ordinance rates are unreasonable, and the chief witness for the defendant, Mr. Polk, states that it would be a mere *gamble* as to whether the Complainant could receive a return on the ordinance rates, assuming no more subscribers to the exchange than at present exist, and assuming the plant to cost only \$1,300,000.00, including real estate.

Trans., p. 1449.

It is respectfully submitted that no one has the right to hazard an opinion as to what the result would be to Complainant if the rates prescribed in the ordinance should be enforced, so far as forecasting where and what classes of patrons it would receive. There is but one safe rule to follow, and that is the experience of the past, and this rule has received the sanction of the Supreme Court of the United States, as above stated, in *La. R. R. Com. vs. Telephone Co.*, 212 U. S., p. 426.

The Master should have reported that there was no reasonable method by which the future could be forecasted if the ordinance rates should be adopted.

The Master states:

"I am by no means satisfied from the evidence that the increase in the number of subscribers will, on an average, increase the cost of operation per telephone or station. In other words, if the company now has nine thousand subscribers, and two thousand additional subscribers be taken on, I do not believe that the cost per station for eleven thousand will be as great as it is for nine thousand subscribers."

Complainant excepts to this statement of the Master because.

(1) The Master disregards the entire evidence of all the witnesses to the effect that increased patronage entails increased expenses.

Trans., pp. 513, 609, 227, 908, 1439, 517 and 518.

(2) The Master entirely overlooks the uncontradicted evidence in the record to the effect that so soon as the present facilities are used, additional facilities must at once be installed so as to at all times have a surplus on hand to care for new patrons in the business.

Trans., pp. 506, 507.

(3) The Master also overlooks the fact in forecasting the future that it is problematical as to where new patronage is coming from. Even where a plant is built brand new, by the time the plant is put into operation, conditions are so changed that the company finds itself in the attitude of having surplus facilities in one part of the city, and the immediate necessity of adding additional facilities in another part of the city.

Trans., pp. 506 and 1434.

(4) The Master overlooks the fact that it is shown in the record that during the taking of this proof, the paramount necessity of supplying additional cable in certain sections of the city confronted the Complainant.

Trans., p. 837.

Mr. Caldwell is asked to state what would be the effect upon the Complainant's business in the event the ordinance rates should be put into effect, and he states:

"My opinion is that we would have to provide a considerable additional capital outlay; that we would get little or no additional gross revenue, certainly we would not get more than would be offset by the additional expense. My deliberate opinion is it would be a very losing and disastrous experiment."

Trans., p. 513.

Mr. Polk says it would be a mere gamble.

Trans., p. 1440.

For these reasons it is insisted by Complainant that the Master should have reported that, if the ordinance rates be adopted:

(1) The future of Complainant's plant in Louisville is too uncertain to forecast; and

(2) Complainant's business would be destroyed.

THE MASTER'S REPORT.

X.

"He will also ascertain and report as to any peculiar advantages, if any, for the steady and reliable earning of income the Complainant may have in said city, and also as to any peculiar disadvantages or risks, if any, which it encounters or may encounter therein, which, with reasonable probability may affect or offset such advantages, and the extent thereof."

In answering this question, I will state that as to the advantages or disadvantages of Complainant for steady and reliable earning of income, there is not much evidence in the record on either side of the question.

The company's plant is well located. It is in excellent physical condition, and it is a remunerative business. If we compare it with the Home Telephone Company as to its earning power, it is obvious that it occupies much the superior position in this: It has extensive toll lines that connect with similar lines extending over the entire United States. Connection with these long distance lines may be had promptly by subscribers, and this, I consider, a most valuable asset, and in my opinion it will in the future, as in the past, materially aid Complainant in its efforts to secure new subscribers.

I find in the evidence no peculiar disadvantages that now affect the earning power of Complainant, or that are likely to do so in the future.

EXCEPTIONS OF APPELLEE.

The Master states:

"I find in the evidence no peculiar disadvantages that now affect the earning power of Complainant, or that are likely to do so in the future."

The Complainant excepts to this statement of the Master, and

insists that he should have reported that the active competition which Complainant has, during the past four years, and now encounters, is a very serious disadvantage to Complainant, in causing Complainant to be unable to earn a proper amount upon the value of its Louisville plant.

In the report of the Board of Trade of New Orleans relative to telephone conditions in New Orleans, it is said:

"Taken as a whole, the telephone business in this country has not been anything like a complete success. There have been innumerable failures, large and small. Competition has been very keen, and not always honest; in many instances, promoters have swindled the public in telephone ventures; distrust has been created; the financial interests of the country have lacked confidence in the business; and, notwithstanding the fact that the telephone is a public utility, savings banks, trust companies and other like institutions do not invest money or trust funds in telephone securities—one of the reasons for this being that the assets could not be turned to any other use than that for which they were originally intended.

"This brings home the fact that the appliances, plant and structures of a telephone company are of a very unstable nature. The property is essentially perishable, easily damaged, and deteriorates very rapidly. The industry has not yet reached a point of stability, and costly appliances are frequently being superseded by other inventions, and have to be discarded long before they are worn out; radical changes are continually being made in construction methods and in equipment, and all these things have contributed to make the telephone business, taken as a whole, an extremely hazardous one. If a telephone company should cease to do business, it would not be able to salvage more than about 20 per cent of the original cost of construction."

Trans., p. 491.

In speaking of the results of competition in the telephone business, this report states:

"Competition does undoubtedly improve the service; both companies strive to please their patrons and are courteous and attentive. Prices are reduced, often to wholly inadequate figures, and the rival companies try, by selling a public utility below cost, to force one another from the field. Thus far, the

public appears to be getting the best of it; but from the start the utility of the telephone as a public service is impaired and after the first years, when it is clear that the business is not giving financial returns, fresh capital is impossible to obtain, the very maintenance charges cannot be met, extension is impossible, and 're-organization' ensues. As the struggle has progressed, the service has been getting worse and worse, and the public is made to feel the disadvantages of competition."

Trans., p. 495.

In speaking of the effect of competition in exchange telephone service, Mr. Caldwell, Complainant's President, says:

"It produces great dissatisfaction, so that no telephone company or system is looked upon as agreeable and satisfying by people that are in such a situation, and the various ordinances which have been passed and experimented with by the city authorities have in a very large measure been the outgrowth of that state of affairs, and an effort to try to cure the difficulty, but the difficulty is inherent in the fact that there is competition in a business and that competition is destructive to the business instead of beneficial."

Trans., p. 519.

He also states that the expenses are greater under competitive conditions, because the business does not flow in a normal way—"The community, telephonically speaking, does not act in a normal way"—and that this produces abnormal expenses and abnormal conditions.

Trans., p. 519.

For these reasons Complainant excepts to this part of the Master's report, and insists that he should have reported:

That competition in the telephone business creates peculiar disadvantages, which must exist so long as competition exists, and that this disadvantage is now being encountered by Complainant.

THE MASTER'S REPORT.

XI.

"The Special Master will also report his conclusions upon such other facts as the development of the case at the hearings before him may appear to be important to a determination of the issues made by the pleadings."

I may say in conclusion, that the expert witnesses in this case have testified as to the value of this plant in such a way as to confuse a Solomon. Men who, by their knowledge and experience, are equally qualified to express valuable opinions as to what it would cost to reproduce a plant similar in all respects to Complainant's plant, differ in their estimates as much as between \$600,000 and \$700,000. But on cross-examination as to the cost of construction, they fail to sustain their opinions by such evidence as a court would ordinarily allow to go to a jury. Several hundred thousand dollars of construction work on Complainant's plant is rested solely upon the Auditor's statement that vouchers representing in the aggregate these large sums were approved by him and were entered on the company's books as proper charges against construction, while he admits at the same time that these book entries, and the distribution of the sums they represented were based solely upon a notation on the vouchers made by some unknown foreman or gang boss to the effect that the work had been done—that it had cost the amount stated in the vouchers, and that the work was for Construction account. The witness did not have personal knowledge of a single feature of any of such vouchers.

The Construction Account, for a number of years, consisting largely of items similar to those just above referred to, contains a very large amount of charges in the aggregate. I was impressed by the idea that it would not be surprising if errors as to the proper distribution of these vouchers had occurred by reason of the carelessness or ignorance of the agents of Complainant who made notations on the vouchers. I have carefully considered the evidence to the effect that the totals of these vouchers were actually paid, and for that reason I

have not disturbed the accounts as they appear in the company's books.

I have ignored the Supplies Account and the working cash capital in making my estimate of the value of the plant, as well as in making a proper allowance for depreciation. The supplies are bought and paid for by Complainant, and when needed by the Louisville or neighboring exchanges, they are retailed to them, and the exchanges pay the Complainant the cost price and an additional ten per cent, and also pay the ordinary expenses of the Supply Department. The cash working capital is furnished by Complainant, and the exchange reimburses Complainant for all the money it uses. The evidence does not show whether interest is charged against the exchange or not.

There is no evidence in the record tending to show that the plant in Louisville is subject to any disadvantages that do not equally apply to all the other plants of Complainant extending over several States. The trend of the testimony is that very small net earnings are derived from the operation of the Louisville plant, while the Complainant pays regular dividends on its stock every six months, and its stock commands a premium of between forty and fifty per cent in the market. No satisfactory explanation of these conditions is offered.

The service rendered by Complainant is good, and the physical condition of its plant is excellent.

I have not seriously considered the testimony offered touching the operations of plants outside of Louisville, because the conditions were obviously different, and the rates there charged and the cost of operation were not necessarily nor directly pertinent to the inquiries I was engaged in.

Respectfully submitted,

HENRY BURNETT,
Special Master.

EXCEPTIONS OF APPELLEE.

The Master speaks of the large difference between the witnesses who have testified as to the value of Complainant's plant in Louisville.

While this is true, the Master fails to state that this difference is brought about by a lack of knowledge of the facts by some of the witnesses.

Complainant excepts to this part of the Master's report and insists that he should have reported that there is no substantial difference between any of the witnesses who speak with a due knowledge of the facts.

Complainant's President, General Manager, Auditor and Assistant Superintendent of Plant do not differ materially as to their estimate of the value of Complainant's plant.

Messrs. Crumb and Levings, two of Defendant's witnesses, show in their evidence on cross-examination that they have not a sufficient knowledge of the Louisville plant to entitle them to express an opinion upon its value. Mr. Polk, the other witness of the Defendant, does not differ materially from Complainant's witnesses whenever he is speaking of matters concerning which he has adequate knowledge.

The differences between Mr. Polk and Mr. Jagoe as to the value of the plant are shown not to be material differences whenever they speak of matters concerning which Mr. Polk has an equal means of knowing the facts.

The most material difference between them is as to the value of the underground conduits. The difference between them on switchboards and other apparatus is with respect to different types of apparatus used for the same purpose. Complainant believes that it is better and safer to purchase its equipment from the Western Electric Company, and Mr. Polk thinks that other equipment, costing much less money, should be used in constructing the plant in Louisville. This difference comes about from the experience of Mr. Polk in building telephone plants. His experience is in building, and not in operating telephone plants; and Complainant's witnesses speak with a knowledge of building and operating plants. Its experience in operating plants has taught its officers to rely upon the Western Electric Company's apparatus. While it is more expensive to purchase, it is believed by them to be more durable and to furnish a more reliable service.

The difference between Mr. Polk and Mr. Jagoe as to cable comes about from the fact that Mr. Polk merely *estimates* that the plant contains certain quantities and sizes of cables, whereas Mr. Jagoe gives actual quantities and sizes of cables, and if Mr. Polk's units of value be applied to Mr. Jagoe's statement of quantities and quality of cable, the difference is not material.

Mr. Polk *estimates* the poles in the plant to be 11,000. Mr. Jagoe states the number of poles to be, by actual count, 13,870. Mr. Jagoe gives the value of these poles, together with the appliances thereon, and the labor of setting them, at what it has actually cost the Complainant during the past two years to erect similar poles in Louisville, and also the price that other companies pay in purchasing a half-interest in similar poles. Mr. Polk *estimates* what, in his opinion, that class of poles should be purchased, equipped and erected for.

For these reasons the Master should have accepted what the witnesses said who have a knowledge of the facts, and not the statement of witnesses who are shown not to have had a sufficient knowledge of the facts to enable them to place a value upon the plant.

The Master states that several hundred thousand dollars of construction work on Complainant's plant is rested solely upon the Auditor's statement that vouchers representing in the aggregate these large sums, were approved by him and were entered on the company's books as proper charges against construction.

Complainant excepts to this part of the Master's report because it appears in what has heretofore been said in reference to the cost of Complainant's plant, that the local Manager, and then the Assistant General Manager, while the facts were fresh and errors easily detected, scrutinized these vouchers, and approved them before they were sent to the Auditor to be entered upon the books and records of Complainant.

Trans., p. 669.

The Master refers to the fact that these vouchers bore the notation of some unknown foreman, or gang boss, to the effect that the work had been done and that it was for construction account, and

further refers to the fact that the Auditor did not have personal knowledge of a single feature of any such vouchers.

Complainant excepts to this part of the Master's report, because there is no other known way in which construction account can be ascertained. The foreman or gang boss is selected because of his ability to know how to do work, and what work has been done. His notation at the time that the work has been done, and on what account, is the best method by which such facts can be ascertained, and when the local Manager, and then the Assistant General Manager, under whose direction such work has been done, examines and approves the notation of the foreman or gang boss, there is no just ground for criticising the method of keeping such records and accounts.

The Master refers to the fact that the construction account for a number of years consisted "largely of items similar to those just above referred to," and amounts to a large sum in the aggregate. He then states that he is impressed by the idea that it would not be surprising if errors "as to the proper distribution of these vouchers had occurred by reason of the carelessness or ignorance of the agents of Complainant who made notations on the vouchers."

Complainant excepts to this part of the Master's report, because it appears that accountants representing the Complainant and the Defendant had full and free access to all of Complainant's books, records and vouchers; that they examined the construction account, and *did* eliminate all errors they found and reported the result to the Master. If there were other errors they were not discovered by the accountants representing either Complainant or Defendant; they were not discovered by Complainant's Auditor, and, while it may be true, as the Master states, that there are other errors, yet Complainant insists that the Master cannot assume that any such errors exist which could affect appreciably the result reported by Complainant's Auditor and the expert accountants representing the Complainant and Defendant, and as shown to have been entered upon Complainant's books from time to time as the work was done and the cost thereof ascertained.

The Master states that he has ignored the Supplies Account and the working cash capital in making his estimate of the value of the plant.

He states that supplies are bought and paid for by Complainant and retailed to the exchanges as needed, and the exchanges pay Complainant the cost price and an additional 10 per cent, and also the ordinary expenses of the Supply Department.

Complainant excepts to this part of the Master's report, because it has been shown heretofore under the heading "Cost of Plant," that supplies have been charged against the exchange at the exact cost to Complainant; that the 10 per cent added was not a profit, but additional cost beyond that paid to the manufacturers, and represented the expense of purchasing, handling and delivering supplies to the various exchanges. The interest on the amount of supplies to the various exchanges. The interest on the amount of supplies necessary to conduct the Louisville plant has not anywhere been charged either to construction or expense of the Louisville plant.

The Master states:

"The cash working capital is furnished by the Complainant, and the exchange reimburses the Complainant for all the money it uses. The evidence does not show whether interest is charged against the exchange or not."

There is no evidence that any of the expenses of conducting the Louisville Exchange includes interest for working capital. It is true as stated by the Master that the exchange reimburses Complainant for whatever money it furnishes, but Complainant submits that the money Complainant furnishes to the exchange upon which it is operated is a part of the capital employed in the business and should be treated as a part of the Construction Account, or a part of the capital necessary to operate a telephone exchange.

The Master states there is no evidence in the record tending to show that the plant in Louisville is subject to any disadvan-

tages that do not equally apply to all other plants of Complainant extending over several States.

Complainant excepts to the report of the Master, because it *does* appear in the record that Complainant has encountered active competition in its business in Louisville; that such competition does prevent normal conditions, telephonically speaking, and that it does actually increase expenses.

It is not shown in the record that Complainant has opposition in its 516 additional exchanges, but it does appear that in the City of New Orleans it does not have competition, and for these reasons Complainant excepts to this statement in the Master's report.

The Master refers to the fact that Complainant pays regular dividends upon its stock, which commands a premium in the market, and that "no satisfactory explanation of these conditions is offered."

From the Annual Report of Complainant for the year ending December 31, 1908, which is in evidence in this case, it will be seen that Complainant has outstanding only \$19,680,150.00 of stock upon which it pays dividends, and that it has invested in plant \$24,381,297.64

That it has invested in real estate and build-	
ings	\$ 790,163.23
Material on hand	640,861.40
Stocks and bonds	435,599.04
Cash	457,546.49
	<hr/>
Or a total of	\$26,705,467.80

It appears in the record that Complainant has a comprehensive system of toll lines uniting its 517 exchanges, and from all these sources it derives a sufficient amount to pay a dividend upon stock of \$19,680,150.00

And five per cent bonds of 1,000,000.00

For the foregoing reasons, and others to be assigned on hearing,

Complainant excepts to the report of the Special Master, and respectfully prays that his findings be disapproved.

Respectfully submitted,

ALEXANDER POPE HUMPHREY,
ALEXANDER POPE HUMPHREY, JR
WILLIAM L. GRANBERY,

Solicitors for Appellee.

Master's Report filed Nov. 17, 1910.

Exceptions filed Dec. 17, 1910.

SUPPLEMENTAL REPORT AND FINDINGS OF THE SPECIAL MASTER.

Since filing my report herein on November 17, 1910, my attention has been called to some matters that are deemed important, which I desire now to submit as a Supplemental Report.

Complainant began its testimony in this cause by introducing as a witness Mr. H. Blair Smith, Auditor of Complainant; and at the conclusion of his direct examination, counsel for Defendant moved "The Master for an order permitting Defendant, through its accountants, to examine said books, records and accounts of Complainant, and for an order directing and requiring Complainant to make a full and complete exhibit, and show all its books and records to Defendant's accountants." This motion was objected to by Complainant, and the objections were sustained and the motion was disallowed.

Thereafter, at a conference between the Special Master and counsel representing both litigants, Complainant's counsel submitted two propositions: One was that the Special Master should select an expert accountant who should examine the books and records of the Complainant Company, and make a report directly to the Special Master, and that this report should be treated as evidence in the cause by both parties.

The alternative proposition was, that each party to the litigation should select an accountant, and that the two accountants thus selected should make a joint examination of the books and records of the Complainant Company, and should make a joint report to the Special Master upon all matters that they could agree upon, and as to all matters they could not agree upon, that each was to file a separate report.

The defendant's counsel agreed to the latter proposition. It was then stated by the Special Master in the presence of counsel for both parties, that whatever these accountants should jointly agree upon, should be accepted as final by the Master, and no proof

should be permitted to vary or contradict such joint findings. As I understood it, this statement was accepted by both parties.

Thereupon, Complainant selected Mr. George Wilkinson as its accountant, and Defendant selected the Mutuald Audit Company as its accountant. During the progress of the work of these joint accountants in examining the books and records of Complainant, a conference was held in Nashville, Tenn., where the records were kept, at which were present counsel representing both litigants, representatives of both accountants, and the Special Master. This conference was held on June 7, 1909, and in this conference the Special Master stated:

"Here are two auditors, by agreement of parties, allowed access to the books of the Complainant Company; and it is agreed that these auditors, after a thorough examination of all the papers connected with the case, shall make a joint report, so far as they may be able to agree, upon any and every proposition. They report, so far as it is the joint report of the two auditors, must be accepted by both litigants, by the Special Master and by the Court, as true; and I take it that no proof ought to be allowed from any extraneous source as to the correctness of that joint report.

Now, as to such matters as these two auditors are unable to agree upon, the Court's order is that each auditor shall then, as to such matters, make a separate report to the Master, and that separate report should contain the reasons in detail of each auditor for his findings. As to these separate reports, if there be any, certainly each party to the litigation would be not only permitted, but it would be their duty, to produce other testimony, if accessible, so as to enable the Special Master and the Court to decide which of these special reports is true."

Then the order was further extended, directing the accountants to file with the Special Master their working papers and memoranda, and that same should be arranged in an orderly and systematic way, with any remarks or indices that they may see fit, so as to identify the papers hereafter.

Further, the accountants were directed to submit, one to the other, the results of their examination, and to state frankly in their reports

their reasons, one to the other, for any position that they might take, in order that the report, when made, shall be, if possible, the joint result of the labors of the accountants; and that when they came to make a separate report, if such should be the case, that each accountant should fully state in his separate report, his reasons for disagreement, and furthermore, his reasons in support of his said report. The accountants were further directed to file with the Special Master a statement that they had not withheld any working papers, memoranda, data or figures obtained by them in their investigation.

I append hereto a typewritten copy of my directions to the expert accountants, which is made a part hereof, marked Exhibit No. 1. (Trans., p. 104.)

Thereafter the accountants did submit to me a joint report, and each submitted a separate report, all of which have been filed by me as a part of my original report herein.

When the evidence was nearly completed, at a conference before me, at which counsel for both parties to this action were present, after considerable argument, I made the following statement:

"It was my distinct understanding when that agreement was made, that whatever the two experts reported jointly, should be accepted as a finality by the Commissioner. Now, I have not seen the report; I have not read a line of any of this testimony, neither have I read either of the reports. If their report on the proposition as to the cost of the Ohio Valley Company, or whatever name it was, appears by the books to be so and so, and they appear to leave that matter open then I would take it that neither party would be bound by that sort of a report. That is the same question that is up here about these depositions. But wherever they report a fact, ascertained by a physical examination of the vouchers, papers and books of the Company, I have always understood it, and so stated to counsel several times, that that would relieve the Commissioner of any investigations as to those points agreed upon by the accountants. . . . I have not read the report. I don't know how they have worded it. I don't know how they have expressed it. I do not know a single point they have agreed upon. I don't know anything about it."

Counsel for Complainant then stated:

"Of course, I don't ask Your Honor to rule now on questions that may arise as to whether they have reported certain facts or whether they have not. Of course, that is the chance I will have to take in preparing my rebuttal proof, as to whether this joint report does cover certain things or not; but the ruling that I wanted is what Your Honor has indicated, that that was the agreement, and that is the one that is to be enforced."

Upon an examination of the joint report, I find that the expert accountants agreed and so reported what the books of the complainant showed as to the cost of complainant's plant, and as to the expenditures for construction, as to the gross earnings and as to operating expenses. The report specifically states as to the foregoing matters as follows:

"The foregoing joint report shows the money charged as the cost of the plant at Louisville, the gross amount credited to the Louisville Exchange as earnings, and the operating expenses charged as appertaining thereto, as recorded on the books of the Cumberland Telephone & Telegraph Company. It is not an agreement that the said accounts are properly distributed or charged as we believe they should be, therefore the right is reserved by each of the undersigned to make such individual report and statement relative thereto as each may feel justified in doing."

The only fact reported by the accountants, to which both agreed, was as to what would be the probable loss in earnings the first year after the ordinance rates should be put into operation. Their finding was that such loss would be \$49,721.76. This fact I adopted in my report, and my calculations are all based thereon.

In accepting the above figures as true, I was not unmindful of the fact that Complainant, in its Bill of Complaint, on page 14, made the following charge:

"If the rates prescribed by said ordinance are put into effect, it will result in a decrease in your orator's revenue, based upon the present rates and present subscribers located within the corporate limits of the City of Louisville, amounting to \$33,504.00."

Neither was I unmindful of the statement occurring in the deposition of Mr. H. Blair Smith, Auditor of Complainant Company, wherein he stated that such loss would amount to \$39,192.00. (Trans., p. 227.)

Saving and excepting the above loss in revenue to be caused by the enforcement of the ordinance rates, I do not consider that the joint report found any fact, except as to what the books of complainant showed. Of course, such a finding ought not to be binding on either party as an ultimate fact.

It is stated in my original report that the depositions of H. W. Ritterhoff and Charles H. Peale were not considered by me. This was an error. Exceptions were filed to the deposition of William Kavanaugh by Complainant, and those exceptions were sustained by me, but these exceptions did not extend to the depositions of Ritterhoff and Peale.

I desire further to state that the Complainant filed exceptions to the depositions of Charles Meriwether, S. M. Wilhite and Chas. E. Archer, and I sustained said exceptions and suppressed those depositions. The reasons for my ruling are given in a paper hereto attached as part hereof.

I desire further to state that a stipulation was filed in this case by the parties, showing what rates the Louisville Home Telephone Company was authorized to charge for telephone service in the City of Louisville during the years 1907 and 1908, and this stipulation is filed with the papers in the case and returned by me to the office of the Clerk.

The original deposition of W. C. Polk, W. H. Kessler Charles E. Archer, Charles Meriwether, S. M. Wilhite, Charles Meriwether recalled, and James F. Grinstead, have been mislaid, and by agreement of counsel on both sides, a carbon copy of the above named depositions is herewith returned; and it is further agreed by counsel that said copies of the depositions may be read and considered as the depositions of said witness.

A written stipulation by counsel on both sides of this controversy, that a copy of D. C. Jackson's report to the Massachusetts Highway Commission might be filed and read on the hearing of this case, is among the papers returned by me to the clerk's office, and same was considered by me so far as I deemed it relevant.

All of which is respectfully submitted.

HENRY BURNETT, *Special Master.*

3
HIGH COURT OF THE STATE OF MISSOURI
FILED
MAY 2 1911
JAMES H. McKENNEY,

No. 751

Supreme Court of the United States

OCTOBER TERM, 1911

CITY OF LOUISVILLE

Appellant

CUMBERLAND TELEPHONE & TELE-
GRAPH COMPANY

Appellee

BRIEF AND ARGUMENT FOR APPELLEE

ALEXANDER FORD HUMPHREY,
ALEXANDER FORD HUMPHREY, JR.,
WILLIAM L. GRABNEY,
Attorneys for Appellee

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1911

No. 761

CITY OF LOUISVILLE. Appellant.

vs.

CUMBERLAND TELEPHONE & TELEGRAPH
COMPANY Appellee.

BRIEF FOR APPELLEE

May it please Your Honors:

This suit was instituted to enjoin the enforcement of an ordinance of the City of Louisville, regulating telephone rates for exchange service in the City of Louisville, upon the ground that the rates prescribed in the ordinance were confiscatory and would, if enforced, deprive the Telephone Company of its property without due process of law.

The case was referred to a Special Master, who made a report sustaining the reasonableness of the rates prescribed in the ordinance; but, on exceptions, the report was overruled, the Court sustained the bill, decreed the ordinance rates to be confiscatory, and enjoined their enforcement.

I.

HISTORY OF THE CASE.

The rate ordinance was adopted on March 6, 1909; the bill in this case was filed on March 7, and the case was at issue on March 31

On April 2, 1909, the case was referred to a Special Master to take proof and report the facts to the Court. Appellee commenced its testimony before the Master on April 14, 1909; its first witness was the Auditor of the Company. At the conclusion of the direct examination appellant's counsel asked permission of the Master to suspend the cross-examination of this witness until opportunity had been afforded appellant to examine appellee's books. Thereupon, by agreement of parties, each side selected a separate accountant, who were required to examine the books of appellee and make a joint report to the Master upon all matters of agreement, and make a separate report on all matters of disagreement—the Master stating at that time that whatever the accountants reported jointly would be accepted as final and conclusive, and no other proof would be permitted upon either side to either vary or contradict the joint findings of the accountants. (Supplement to brief, p. 189.)

The accountants commenced their examination on May 3rd and concluded the same on July 11th. Thereupon the cross-examination of appellee's auditor was resumed on August 30, 1909. The evidence was concluded in April, 1910, and the matter submitted to the Master, who filed his report on November 17, 1910. The case was in due course submitted, and was determined in favor of appellee on April 25, 1911.

II.

THERE IS NO PRESUMPTION IN FAVOR OF THE RATES PRESCRIBED BY THE CITY ORDINANCE.

It is doubtful whether any reduction in rates by a City Council should be presumed proper, when actual and active competition exists. This record shows that since 1902 the Louisville Home Telephone Company has had a telephone exchange in Louisville, and that the competition between the two companies has been, and still is, actual and active. Under such conditions, competition is sufficient regulation, and proves the reasonableness of the rates being charged.

The bill charges that this ordinance had been adopted without any investigation or knowledge of whether the rates prescribed were reasonable or unreasonable. This was denied in the answer. The

record shows that the City authorities only had knowledge of what *some other* companies in *some other* cities were charging for telephone service, and had examined the books of the Louisville Home Telephone Company.

The mere fact that *other* companies in *other* cities were charging different rates could not be of any value in determining reasonable rates in Louisville. Indeed, there was in Louisville another company in active competition with appellee charging \$4.00 per month for a business telephone against \$7.50 by appellee, and \$2.00 for a residence telephone against \$3.50 by appellee. The *value of the service* is the thing that counts, and determines the *cost of giving* the service. As was said by one of the witnesses:

"There is an individuality about every plant that you cannot separate from it. There are conditions in every city that are different from the conditions in every other city, and one of the biggest features that often escapes attention is the class of service given. We can serve ten thousand subscribers of one class for one-third of the construction expense that we can serve ten thousand subscribers of another class, and then it is possible to give connection to subscribers at one price and then by increasing the efficiency of the service, or the reliability of the service, to add fifty per cent to the construction value."

Jagoe's dep., Trans., vol. 1, p. 631.

"A telephone plant is not different from any other property, real estate, or any other kind of property. You can build a four-room house for a couple of hundred dollars, or you can build it for a couple of thousand dollars. The telephone plant is similar to any other property in that way. The better you make the plant the more expensive it is, and one peculiar condition is that you can get service up to a certain point very cheaply to everybody, but you add to the efficiency; if you add 5 per cent to the efficiency, you will add more than 5 per cent to the cost, for the last 10 per cent of efficiency of your service will amount to 50 per cent of the cost of your plant."

Trans., vol. 1, p. 661.

A comparison of rates in other cities is actually misleading. The Commissioner of the Board of Trade in New Orleans in his investigation of telephone rates, said:

"More than five hundred letters have been written and received by me in the course of this inquiry, and I have sought the opinions of men connected both with the Bell and the Independent Companies. . . .

"When I had classified and examined the replies received to my queries from the various telephone companies, it became abundantly apparent that, insofar as the fixing of telephone rates is concerned, comparison with other cities is worse than useless—it is absolutely misleading. There are no two cities in the United States where conditions are sufficiently similar to warrant comparison. It is a fact beyond dispute that the question of telephone rates is purely and essentially a local one; and is controlled by four factors: First, the cost of the plant; Second, the cost of operation and maintenance; Third, the amount of taxes and dues paid to the city; Fourth, the rapidity of depreciation, due to the climatic conditions."

Trans., vol. 1, p. 489.

The answer is sworn to by the Mayor of the city, and presumably reflects the attitude of the city officials. The answer avers:

"Said complainant company has a substantial monopoly on all long distance service in and around Louisville on account of its connection with the American Bell Telephone Company. All customers of the complainant company who are compelled, for business reasons, to have long distance connections with customers outside of the City of Louisville are compelled to pay the highest possible price for their telephone service, and the rates charged have been gradually increased on all such customers. To all customers who do not require long distance service, said complainant company will furnish, and does furnish, a telephone of the same character as above mentioned at a much less rate, and, in many instances, furnishes such telephone service for a nominal charge only; that such course has been pursued in order to stifle competition; that the result has been that many customers and citizens of Louisville are charged rates at less than the cost of the service furnished, thereby imposing on the customers of said complainant company who are so situated as to require the service of the complainant's long distance connections the necessity of paying the complainant company's losses in trying to crush out competition.

"Defendant says that the situation above detailed became so burdensome to some of the citizens of the City of Louisville that the Mayor and General Council of the City of Louisville attempted, in the year 1908, to remedy the situation by passing

an ordinance authorizing the sale of a franchise for a comprehensive system of telephones in the City of Louisville, which it was hoped by the Mayor and General Council of the City of Louisville, would result in one comprehensive system of telephones, with the right to charge such uniform rates as would be fair and just to all citizens, and at the same time permit the company acquiring such franchise to operate its system of telephones and obtain a fair return on its investment.

"Defendant says that said ordinance was prepared by the City Attorney of the City of Louisville upon request of the Mayor; that it was introduced in one of the Boards of its General Council, and passes said Board by practically a unanimous vote, and was favorably reported to the other Board of its General Council, and would have been adopted by said Board and approved by the Mayor but for the fact that the complainant company, through its President and Attorneys, appeared before the Mayor of the City of Louisville and before the Board of Aldermen of the City of Louisville and stated to said Mayor and to said Board of Aldermen that the complainant company had a franchise which was irrevocable and irrevocable, and that the City of Louisville was powerless to interfere with the rights of the complainant company in the conduct of its business or otherwise in the City of Louisville, and said officials and attorneys for said company further stated in unequivocal terms to the Mayor and Board of Aldermen of the City of Louisville that it, the said complainant company, would not become a bidder at the sale of such a franchise or in any manner acquire, or attempt to acquire, the franchise which, by said ordinance, was proposed to be sold.

"Defendant says that by one of the provisions of said ordinance, viz., Clause 16, it was proposed to repeal the ordinance which was approved on August 17, 1886, referred to in the Bill of Complaint, and that said repealing clause of said ordinance was in substance the same as the repealing ordinance referred to in paragraph 3 of the Bill of Complaint. Defendant files a copy of said proposed ordinance herewith and makes same a part hereof, marked 'Exhibit A.'

"Defendant, therefore, says that inasmuch as the defendant, at the time it first proposed to repeal the ordinance under which the complainant claims its right to conduct its business in the City of Louisville, proposed at the same time to offer for sale a franchise similar in nature to that now exercised by the complainant company, and inasmuch as the complainant refused to

become a purchaser, or to acquire the franchise so proposed to be sold, said Board of Aldermen declined to pass the ordinance above mentioned, and in lieu thereof, passed the ordinance referred to in the Bill of Complainant, being the ordinance referred to in paragraph 3 of the Bill of Complaint."

The copy of the ordinance attached to the answer, providing for the sale of a franchise for a comprehensive telephone system, prescribes a maximum business rate of \$6.00 per month for a business telephone for the first ten years of the franchise, and \$7.00 per month for the last ten years.

The rates in the ordinance in this suit prescribed a maximum business rate of \$5.50 per month.

While the answer says that the conduct of appellee in giving poor service, and in being arbitrary, dictatorial and offensive to the citizens of Louisville, caused the city to have prepared and introduced the ordinance creating a franchise for a comprehensive telephone system, yet it was immediately withdrawn, when it was stated by appellee that it would not be a bidder therefor.

While the answer avers that appellee charged some of its customers extortionate rates and some others rates below cost of service, and that the city desired to correct this practice, yet the ordinance does not require all patrons to pay the same amount, but merely fixes *maximum* rates, leaving appellee to charge as much less as it may desire.

While the answer avers that poor service and discrimination was the real complaint against appellee, yet the ordinance dealt with nothing but prescribing *maximum* rates.

While the answer avers that the service was poor, the Master reports the service good, and there is no exception to his so reporting.

The answer avers that competition in the telephone business caused the irritation, and the city authorities sought to remove the irritation by selling another franchise and getting rid of competition, *not* by destroying appellee, *but* by destroying its competitor

This must have been the idea, since the ordinance for the new franchise was withdrawn so soon as appellee advised the city that it would not be a bidder therefor.

The proposed franchise prescribed certain maximum rates, but because appellee would not surrender its franchise, and buy a new one, the city passed another ordinance, prescribing *lower* rates.

Hence, appellee insist that instead of there being a presumption *in favor* of the rates, the presumption is the other way.

Again, the evidence shows there was no investigation or hearing on the rates prescribed. The Mayor in his deposition shows that the city *investigated* the Home Telephone Company, and then *regulated* the Cumberland Company. And more than this: Having made a so-called investigation of the Home Company, the ordinance prescribing the rates expressly excluded the Home Company from its provisions.

III.

THE MASTER'S REPORT.

The Master was directed by the Court, in the order of submission, to report:

- (1) The cost of the plant;
- (2) The value of the plant as of March 6, 1909, and as of the date of his report;
- (3) The gross and net earnings for each of the years 1905 to 1908 inclusive;
- (4) The probable gross and net earnings for 1910, if the ordinance rates had been in force;
- (5) What amount should be set aside from earnings annually for depreciation;
- (6) Whether the increase in business under the ordinance rates will, in succeeding years, yield a fair return upon the value of the plant;
- (7) What is the average return on business enterprises in Louisville approximately resembling a telephone plant, and whether such return is above or below 6 per cent of the value of the property of such enterprises;

(8) Whether the income for 1910 on the telephone plant would have been above or below the income derived from other enterprises in Louisville, if the ordinance rates had been in force;

(9) The probable increase in the business, and the effect upon its gross and net earnings;

(10) The advantages, if any, for reliable earnings and income from the plant in Louisville, and the disadvantages and risks, if any;

(11) Such other facts as may appear of importance to the determination of the issues made in the pleadings.

As stated, the Master sustained the reasonableness of the ordinance rates, but any one of several patent errors of fact are responsible for this result—although numerous other smaller errors of facts and the misapplication of facts appear in his report.

The Court, upon exceptions, overruled the conclusions of the Master in an elaborate written opinion.

Vol. 2, p. 1618.

In presenting the case in this brief, it has been thought that it would be of advantage to the Court to follow the order of reference, the report of the Master, and the opinion of the Court below.

It may be stated now that everyone concedes that the earnings for 1908, the last of the four years shown in this record, is the most *favorable* to the contention of the city and the most *unfavorable* to the contention of the company. Hence, only the year 1908 will be considered, in order to prevent confusion.

The Master was directed to report:

IV.

THE COST OF THE PLANT IN LOUISVILLE TO MARCH 6, 1909, THE DATE THE RATE ORDINANCE WAS ADOPTED.

In June, 1899, the Ohio Valley Telephone Company was conducting a telephone business in Louisville and in towns adjacent to Louisville. All the stock of this company was purchased by appellee, and in January, 1900, the two companies were consolidated under the

name of appellee; 2,855 shares were purchased at \$141.00 per share of \$100 each, and 702 shares were purchased at \$140.00 per share. This left outstanding 1,937 shares, which were purchased by appellee exchanging a like number of its own shares, which likewise had a market value of \$141.00 per share.

From the time of this purchase in June, 1899, to January, 1900, when the properties were consolidated, the Ohio Valley Telephone Company was operated as a separate corporation. No further dividends were paid on its stock, but the earnings were put back into the plant. Appellee paid some of its debts, it loaned it money, and its properties (including the Louisville Exchange) were added to, and improvements made to existing plants—so that at the time of the consolidation in January, 1900, the properties received by the consolidated company were different and of greater value than they were in June preceding, when the stock was purchased. And when the books of the consolidated company were opened, these properties were put down at a larger value and cost than the books of the consolidating company showed them to have cost in June preceding.

The officers of the consolidated company, being the same as the officers in each of the consolidating companies, placed in the books of the consolidated company the cost of the plants, as they appeared from their records, and the cost of the Louisville exchange was stated to have been \$678,354.00. The Master reported the cost to have been only \$457,579.07.

Only two errors of the Master need be noted in this connection, these and all others are fully pointed out in the exceptions to his report. (Supplement to brief, pp. 15 to 40). The purchasing company exchanged 1,937 shares of its stock, worth in the open markets \$141.00 per share, for a like amount of Ohio Valley stock, likewise worth in the market \$141.00 per share. In placing upon its books the cost to it of these 1,937 shares, the purchasing company allowed a premium of \$41.00 a share, so that the cost was stated on its books at \$273,117.00, instead of its face value \$193,700.00. The excess cost and the excess market value was \$79,417.00, which the Master deducted from the cost as shown on appellee's books.

It was insisted by appellee that since its shares were selling for a premium of \$41.00 in the open market, and it purchased a large number of shares of the Ohio Valley Company at a premium of \$41.00 per share, that in determining the cost to appellee of the shares acquired by exchanging a like number of its own shares, this premium of \$41.00 per share must be allowed, since it is apparent that if appellee had sold 1,937 shares of its own stock it would have received \$79,417.00 *more than* its par value, and if it had purchased for cash the 1,937 shares of the Ohio Valley Company's stock, it would have paid therefor \$79,417.00 *more than* its par value.

Again, if appellee acquired 1,937 shares of Ohio Valley Company's stock at par, it received property which was worth \$79,417.00 *more* in the open markets of the country than was paid for it, and it gave for these 1,937 shares property that was worth \$79,417.00 *more* than their par value.

The Master, conceding that the Ohio Valley Company's stock was worth in the open markets of the country a premium of \$41.00 per share, held that because of the *manner* in which appellee acquired 1,937 shares, its value decreased \$41.00 per share, or a total of \$79,417.00, when any other purchaser would have paid therefor a premium of \$79,417.00; and appellee itself could immediately, after acquiring these shares, have sold them for a premium of \$79,417.00.

This error of the Master reduced the cost of the plant \$79,417.00.

The remaining differences between appellee and the Master as to the cost of the Louisville exchange in January, 1900, comes about in this way: The Master stated the cost in January, 1900, to be what appellee had paid for its share capital in June preceding, and then deducted this premium of \$79,417.00. The Master overlooked the obvious fact that stock only represents the equity of stockholders in the corporate assets. The *cost* of the corporate assets is the cost of the stock, plus the amount of the indebtedness of the Company. The cost of land under mortgage is the price paid for the equity plus the amount of the mortgage.

These two manifest errors of the Master account for his reduction in the cost of this exchange to January, 1900.

After the purchase of the telephone exchange in Louisville in January, 1900, it was added to from time to time as new patrons were obtained, and the public needs required. In this way, there was added to the exchange between January, 1900, and March 6, 1909, construction, which the books of the company show cost \$1,023,545.34. That this money was spent on the Louisville exchange, there is no dispute. The experts representing both parties so reported, and they examined not only the books, but the original vouchers for this entire amount. Supplement to brief, p. 9.

The Master reduced this amount \$100,000.00, because he thinks a part of this amount should have been charged to maintenance, or to reconstruction, but when he comes to ascertain the amount spent on maintenance and reconstruction, he does not allow any part of this \$100,000.00 in his report of expenses. Having conceded that large parts of this \$100,000.00 had been actually expended on the exchange, and having disallowed it in the cost of construction, the Master should have allowed it as expense, but he does not allow it *any where for any purpose*.

Again, the Master says that about \$50,000.00, charged by appellee as added construction to the exchange, and so reported by the experts, was an erroneous charge. The facts are that appellee, conducting a large business over several States, and having need for various kinds of material and supplies almost daily, in constructing, maintaining and reconstructing its various exchanges and toll lines, has established warehouses at different points in its system. It purchases materials in large quantities, ships them to these warehouses, and then furnishes them to its exchanges, and charges to these exchanges the cost of the material and supplies so furnished. All this the Master agrees to be right. But the actual cost of the materials and supplies is not all the cost to the company of such materials and supplies so delivered to the exchanges. There is to be added freight, drayage, insurance, rent of warehouse, clerk hire in receiving and issuing materials and supplies. These expenses amount to 10 per cent of the first cost of the materials and supplies, and are added to the invoice cost in charging the exchange with the materials and supplies so furnished.

The Master thinks this 10 per cent is a profit to the Company and declines to allow it as an expense. The Master says:

"I find that this charge on all supplies furnished is at least a burden on the business in Louisville, and should not be allowed. The Company in the first instance must have paid freight and drayage on all supplies furnished. The Company doubtless received the usual trade discount for cash. As to how the freight and drayage were charged, or the cash discount credited, the record is silent. I do not doubt that proper and correct entries were made on the company's books as to the rent of the supplies warehouse. This is doubtless charged to expense of supplies.

"The amount of this ten per cent added charge, like the items of wages, is a matter of conjecture, but it is obviously a substantial amount, extending from 1900 to 1908, both inclusive. At the argument, counsel for Complainant admitted that the items of drayage, freight, rental, etc., are charged primarily to Supply Expense, but that ultimately they are charged to the operation of the exchange."

In the first instance, all these small items of expense *are* charged to "supply expense," but when the supplies are thereafter furnished to the exchange, both the cost of supplies and the expense of handling the supplies must be charged to the exchange. The Master may as well have said that the cost of supplies having already been charged to supplies, could not thereafter be charged to the exchange. If the accounts of the company had not been kept this way, no one could ever tell what any exchange had cost. But the Master evidently believed this added 10 per cent supply expense was a profit and not an expense. This is clearly erroneous. A merchant buys his goods, but he also must rent a store, insure his goods, and employ clerks to sell them. All *this* is expense and must be *added* to the cost of the goods before any profit to the merchant can be considered.

These errors resulted in the Master reporting a cost of the plant to have been only \$1,381,124.41, when the books of the appellee show the cost to have been \$1,700,045.26.

The examination of the expert accountants "involved a close inquiry in all matters relating to the business of the Complainant in the City of Louisville, including the books, accounts, vouchers,

pay rolls, agents' reports and other original sources of information, kept at the principal office of the Complainant in the City of Nashville, Tennessee," and they reported that the plant had cost complainant to March 9, 1909..... \$1,702,391.68

This was not what the books of the appellee showed the plant to have cost, but was what these accountants agreed the books *should have shown after errors had been eliminated.*

The books of the company showed the cost of the plant to have been..... \$1,700,045.26

To this must be added the real estate, which every one concedes cost the sum of..... 160,841.42

The Court, in deciding the case, deemed the cost of the exchange immaterial in view of the evidence of its present value, and did not attempt to ascertain its original cost. In this the Court was of course correct.

The Master was directed to report:

V.

THE VALUE OF THE EXCHANGE ON MARCH 9, 1909, THE DATE THE RATE ORDINANCE WAS ADOPTED.

The Master did not ascertain present value, but said:

"The estimates of the witnesses as to present value are irreconcilable. It may be conceded that the opportunities of some of the witnesses for accurate knowledge on the subject are superior to those of others. This assumption is undoubtedly true. I would not be fair in assuming that either of the witnesses is guilty of knowingly making misleading statements.

"Convinced as I am that my finding as to the cost of the plant is correct, I am, for the reasons stated, persuaded that the value of the plant as of March 6, 1909, all features of depreciation considered, ought to be and is..... \$1,381,124.41
 • Less depreciation of ten per cent..... 138,112.44
 Leaves..... \$1,243,011.97

"This does not embrace real estate nor toll lines nor working capital, if any should be allowed."

The Court found the value of the plant, including real estate (\$162,000.00), working capital and supplies on hand, (\$51,000.00), toll lines (\$125,406.80), to be \$1,788,000. The value of the plant, as found by the Court, after deducting real estate and toll lines, is \$1,500,593.20. This does not allow anything for "going concern," or "franchise" value, which has stood upon appellee's books at \$80,000.00 ever since January, 1900.

When the Master was directed to ascertain and report the fair value of the plant, it meant something more than merely stating its cost. Yet this is all that he does. The Master seems to have been perplexed at the conflict of evidence, and abandoned the task of ascertaining value as a hopeless one.

In our view of the matter, the task is by no means so difficult as it appeared to the Master.

The valuations given by all the different witnesses who testified are:

Smith's total.....	\$1,688,511.94
Jagoe's total.....	1,793,540.30
Polk's total.....	1,085,637.00
Crumb's total.....	975,000.00
Leving's total.....	1,000,000.00
Prof. Jackson's total, estimated according to his units of cost.....	1,779,413.18
Hume's total.....	1,793,540.30
Caldwell's total.....	1,702,391.68

Mr. Smith is appellee's auditor, and has been for twelve years.

Mr. Jagoe is appellee's superintendent of plant, whose duty it is, and has been, to supervise construction, and ascertain cost of construction.

Mr. Polk is a telephone engineer living in Toledo, Ohio, but has constructed plants in different parts of the country and built the Louisville Home plant in 1901 and 1902.

Mr. Crumb is a telephone engineer, living in Chicago, Illinois.

Mr. Levings is editor of a telephone journal in New York, but was formerly a clerk to an engineering firm in Chicago.

Prof. Jackson is a telephone engineer, and made a valuation of all the telephone plants in Massachusetts for the Highway Commission of that State.

Mr. Hume is appellee's general manager, has had twenty-five years' experience in the telephone business, and for more than ten years has had an intimate knowledge of the Louisville plant.

Mr. Caldwell is appellee's president, and has also had twenty-five years of experience in building and operating telephone properties, and has had an intimate knowledge of the Louisville plant since 1899.

It may be assumed, for the argument, that each of these witnesses is *equally* truthful, and *equally* competent.

However competent and truthful a witness may be, he must have a knowledge of the plant before his *estimate* of value is entitled to consideration.

As was said by one of the witnesses:

"The cost of reproduction is a matter of individual opinion; no engineer in estimating on the several important items of construction work for the year will come within ten per cent of the total aggregate cost. Many of the more important items are frequently under-estimated from twenty-five to fifty per cent. If experienced engineers, knowing the local conditions, cannot estimate the exact cost, how can those without special knowledge be expected to do so? A very good illustration of this may be had by contrasting the original estimates with the ultimate cost of postoffices and other public buildings. An especially good illustration, and one known to all readers of the daily press, is that of the Panama Canal. The original estimate of the cost of engineering and construction work was \$139,705,200, but the present estimate is \$297,766,000, and it is probable that this cost will be greatly exceeded."

Hume's dep., Trans., vol. 1, p. 678.

Another witness says:

"There is an individuality about every plant that you cannot separate from it. There are conditions in every city that are different from the conditions in every other city, and one of the biggest features that often escapes attention is the class of service given. We can serve ten thousand subscribers of one class for one-third of the construction expense that we can serve ten thousand subscribers of another class; and then it is possible to give connection to subscribers at one price and then by increasing the efficiency of the service, or the reliability of the service, to add fifty per cent to the construction value."

Jagoe's dep., Trans., vol. 1, p. 631.

And on page 661 he says:

"A telephone plant is not different from any other property, real estate, or any other kind of property. You can build a four-room house for a couple of thousand dollars. The telephone plant is similar to any other property in that way. The better you make the plant the more expensive it is, and one peculiar condition is that you can get service up to a certain point very cheaply to everybody, but you add to the efficiency; if you add 5 per cent to the efficiency, you will add more than 5 per cent to the cost, for the last 10 per cent of efficiency of your service will amount to 50 per cent of the cost of your plant."

The Master very properly discarded the *estimates* of value given by Messrs. Crumb and Levings, because it clearly appeared that they had no knowledge of the plant, and their *estimates* of value need not receive further consideration.

Mr. Polk *did* have a *general* knowledge of complainant's plant in Louisville, *as it existed in 1902*. He at that time built the Home Telephone Company's plant in Louisville. But Mr. Polk admits that his estimate of the present value is only an *estimate*. He does not claim to have made an inventory of the plant, nor does he accept *ascertained quantities* of material in the plant, *but persists in estimating quantities of materials, far less than the undisputed evidence shows to exist in the plant*.

Under these circumstances we insist that his *estimate* cannot be accepted, if there be other evidence by *equally* competent witnesses, who have ascertained *actual* quantities of material in the plant, and applied *known* units of value thereto.

In order to facilitate the labors of the Master, and realizing that so long as mere *estimates* of value were to be reconciled by the Master, the task would be confusing and unsatisfactory, appellee caused its Superintendent of Plant to make a careful *inventory* of the plant, and submit it for the consideration of the Master.

The labor and time involved in making this inventory was very great, covering as it did a period of more than two months. Mr. Jagoe was in charge of this work, but as each item of material in the plant and its value was ascertained, it was submitted to appellee's General Manager, who is shown to be a thoroughly competent engineer of twenty-five years' experience, and under whose direction all additions to this plant for ten years had been made. So that the valuation made by Mr. Jagoe was approved by Mr. Hume, the General Manager.

A valuation arrived at in this way should not be lightly cast aside. Unless there be some controlling reason, it should be accepted.

An *inventory* is more than a mere *estimate*. It is not an estimate at all. It is the ascertainment of facts. Some of the cases speak of the valuation of real estate being an estimate, and so it is, but an inventory of a stock of goods, a lumber yard, a factory, or a telephone plant is not an estimate, but a fact. It is the best, if not the only way in which the "fair value" of a plant can be ascertained.

So we insist that the inventory of this plant must be accepted, unless it is shown to be fraudulent, or made on an improper basis.

The Master expressed dissatisfaction with it in two respects only. He thinks the underground system is valued too high, and reduces this valuation \$37,561.11.

Mr. Jagoe's inventoried valuation was, as shown above	\$1,793,540.30
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There must be deducted from this amount the item last above mentioned of	37,561.11
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Leaving a valuation of	\$1,755,979.19
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The Master has criticised this inventory in *only* one other respect, and that is, the "overhead charges." If overhead charges are *not* proper, the Master's criticism is just. If overhead charges *are* proper, the criticism of the Master is unjust.

The Master states that after eliminating overhead charges from the inventoried value of Mr. Jagoe, and after eliminating the over-valuation of the underground system, there remains as the inventoried value \$1,587,447.55

This reduces the inventoried value of the plant, *after* deducting \$37,561.11 for excess value on the underground, and \$168,531.66 for overhead charges, leaving the "bare bones of the plant," to \$1,587,447.55

The only question that can properly arise is whether the proper units of value have been applied to ascertained quantities.

Prof. Jackson is a member of the Society of American Institute of Electrical Engineers, the American Society of Mechanical Engineers, and the American Society of Civil Engineers, formerly professor of Electrical Engineering of the University of Wisconsin, and later professor of Electrical Engineering in the Massachusetts Institute of Technology of Boston; he was the Chairman of the Telephone Commission appointed by the City of Chicago in 1907 to investigate the telephone conditions in that city, to prepare an estimate of the value of the telephone plant, to determine what it would cost to build an adequate plant, what the expense of conducting such a plant would be, and what rates would be reasonable and fair for the city to impose upon the operating company.

During 1908 and 1909 he was engaged under the employment and direction of the Massachusetts Highway Commission in preparing an inventory and valuation of the entire properties of the New England Telephone Company in the State of Massachusetts.

In order to value the plant of the New England Company in Massachusetts, after having ascertained quantities of material throughout the State, embraced in the various plants, it became necessary for him to ascertain units of cost for the various kinds and classes of material in the plants, and this he did.

As pointed out by the Master, if the units of value used by Prof. Jackson be applied to the quantities of material actually in this plant, the valuation is slightly in excess of Mr. Jagoe's inventoried value.

Overhead charges must be added in ascertaining the "fair value" of a plant.

It is respectfully submitted that in view of the fact that every witness in the record, every scientific writer on the subject, and all the Courts recognize overhead charges as a part of the value of the plant, the Master is in error in declining to allow any amount as overhead charges. It is undoubtedly true that a plant is worth more in a completed condition ready for business, than are the various materials unassembled, which constitute the plant. Before the material constituting the plant can be erected, there must be the services of a financier who conceives the enterprise and who determines what kind of a plant should be built; there must be an organization and the issuance and sale of securities with which to buy the material and build the plant; there must be a competent engineer who surveys the field and determines the location and the method of constructing the plant; there must be supervision during construction; there must be provision made for interest on the money invested during the building of the plant; there must be provision made for teams and tools used in constructing the plant, and which wear out during the construction of the plant; there must be provision made for accidents due to negligence during the progress of construction; there must be insurance on parts of the plant as constructed before its completion; and over and beyond this, there must be an amount provided for contingencies, accidents, unknown and unforeseen emergencies, so that when the plant is completed ready for operation, it has cost more than the manufacturers price on the material, the freight in getting it to the place where it is to be erected, and the labor of erecting it.

The Master thinks that nothing should be allowed for any of these items and we submit that if this record were barren of proof, the Court would judicially know that such expenses are necessary, and are of necessity a part of the value of the plant.

The lowest amount given by any of the witnesses for these items is by Mr. Polk, appellant's expert. We accept his valuations.

Mr. Polk allows for:

Taxes, rent and insurance during construction.....	\$ 5,000.00
Soliciting and right of way.....	15,000.00
Engineering and supervision.....	20,000.00
General legal miscellaneous.....	50,000.00
Total.....	\$ 90,000.00

Trans., p. 1517.

Working Capital.

The Master states that he has not allowed any amount for working capital. That *something* must be added for this is self evident.

In the Gas case, Judge Hough allows 3.5 per cent of the value of the plant.

Consolidated Gas Co., vs. New York, 157 Fed., 861.

The Supreme Court did not disturb this item.

Wilcox vs. Consolidated Gas Co., 212 U. S. 49.

Mr. Wilkinson allows for the Louisville Exchange \$33,353.15.

The Chicago Commission's report shows:

The Manufacturer's Tel. Co., estimated working capital at.....	\$ 400,000.00
The Chicago Telephone Co., at.....	500,000.00
The Telephone Commission allowed.....	300,000.00
Mr. Polk allows for supplies alone, the sum of.....	18,000.00

It would seem that the amount allowed by Mr. Wilkinson ought not to be contested. This amount is..... 33,353.15

Franchise value must be included.

It is shown without any contradiction that on January 1, 1900, when the properties of the Ohio Valley Company were taken over on the books of the Cumberland Telephone and Telegraph Company, the franchise stood on the books of the Company at a valuation of \$100,000.00.

If the franchise value of \$100,000.00 be divided between Louisville and the other places where the Ohio Valley Company had exchanges, 80 per cent will belong to the Louisville Exchange. The Master approves and accepts this division of the physical properties, and hence the franchise value must be separated in the same way.

This gives to Louisville a franchise value of \$80,000.

In the New York Gas case the value of the franchise was allowed by Judge Hough as placed upon the books of the Company, to which he added \$5,000,000.00 for increased valuation since it was placed upon the books of the Company, at the time of the consolidation. This Court reversed Judge Hough in this respect, and held that the franchise value was to be limited to the amount at which it was taken over by the consolidated company from the consolidating companies.

Consolidated Gas Co., vs. New York, 157 Fed., 861.

Wilcox vs. Consolidated Gas Co., 212 U. S. 49.

Therefore it is insisted by complainant that franchise value of \$80,000.00 must be added to the valuation of the physical property in order to ascertain "the fair value of the plant."

In valuing a plant such as Appellee has in the City of Louisville, "going concern" must be included as one of the elements of value.

The value of "good will" and the value of "going concern" are wholly separate and distinct things, although the terms are often used interchangeably, and these two elements of value are oftentimes confused because of a failure to recognize the fact that they are separate and distinct things.

"Good will" is all that good disposition which customers entertain towards a house or business identified by the particular name or firm which may induce them to continue giving their custom to it."

Washburn vs. National Wallpaper Co., 81 Fed., 20.

Judge Hough after quoting this language, proceeds to discuss the question as to whether the New York Gas Company is entitled to any added value on account of "good will" and he points out that a public service company under monopolistic conditions cannot have such a thing as "good will" value, because its customers must trade with the company whether they desire to do so or not.

Consolidated Gas Co., vs. New York, 157, Fed., 872.

In *Omaha vs. Omaha Water Works*, 218 U. S., 202, Mr. Justice Lurton, delivering the opinion of the Court, clearly distinguishes "good will" from "going value," or, as it is otherwise called, "going concern" value.

In that case the appraisers had included \$562,712.45 for "going value." This was within a slight fraction of 10 per cent of the physical value, and this was allowed as a part of the valuation of the plant, quoting, with approval, the decision of Judge Brewer in *National Water Works vs. Kansas City*, 62 Fed., 853.

Judge Brewer, in the *Kansas City* case, allowed \$286,000.00 as the value of "going concern" on a physical plant worth \$2,714,000.00, which is slightly in excess of 10 per cent.

The amounts allowed, both by Mr. Justice Lurton in the *Omaha* case, and by Judge Brewer in the *Kansas City* case, were for "going concern" and were not for "good will."

Mr. Justice Lurton in the *Omaha* case, points out the difference between "going concern" and "good will." He shows that "good will" as suggested in the *Consolidated Gas* case has no commercial value when the business is a monopoly; but whether there be a monopoly or not, there is a "going concern" value, or as Mr. Justice Lurton says: "That there is a difference between even the cost of duplication, less depreciation, of the elements making up the Water Company's plant, and the commercial value of the business as a 'going concern' is evident."

It may not be amiss to quote briefly from the opinion of Judge Brewer in the *Kansas City* case. He says:

"The original cost of the construction cannot control, for 'original cost' and 'present value' are not equivalent terms. Nor would the mere cost of reproducing the water works plant be a fair test, because that does not take into account the value which flows from the established connection between the pipes and the buildings of the city. It is obvious that the mere cost of purchasing the land, constructing the buildings, putting in the machinery and laying the pipes in the streets—in other words, the cost of reproduction—does not give the value of the property as it is to-day. A completed system of waterworks, such as the company has, without a single connection between the pipes in the streets and buildings of the city, would be a property of much less value than that system connected, as it is, with so many buildings, and earning, in consequence thereof, the money which it does earn. The fact that it is a system in operation, not only with a capacity to supply the city, but actually supplying many buildings in the city—not only with a capacity to earn, but actually earning—makes it true that 'the fair and equitable value' is something in excess of the cost of reproduction."

In *State, etc. vs. Commissioners*, 106, Fed. 7, Judge Simonton tersely states the proposition as follows:

"The basis of all calculations as to the reasonableness of rates, is the fair value of the property used for the convenience of the public—not its cost nor the amount of money expended for it, but its value as a productive factor, taking into consideration its location, character of country through which it passes and the reasonable expectation of business coming to it. The railroad company is entitled to a fair return upon the value of the property, ascertained in this way, and is not entitled to exact from the public more than this."

To the same effect are:

Smyth vs. Ames, 169, U. S., 466.

Chicago, etc. vs. Thompson, 176, U. S., 167.

The case of *Smyth vs. Ames*, 169, U. S., 466, is probably the leading case in this country on this subject. In that case, the test is the fair value of the property used for the public.

If, therefore, the company is entitled to a reasonable return upon the fair value of its property, this element of "going concern" must be included, because all of the Courts hold that it is a part of the value of the plant, and there *is* a value beyond the "bare bones of the plant," as was said by Mr. Justice Lurton in the Omaha case.

The only question left for consideration is the amount that shall be allowed. Judge Brewer allowed a fraction in excess of 10 per cent of the physical property, and this Court in the Omaha case approved an amount little less than ten per cent. In this case, if only \$50,000.00 be allowed, there can be no just criticism.

SUMMARY.

With the data before us, we propose to show the Court that the valuation contended for by appellee is conservative, and fully sustained.

We contend for a valuation of	\$1,702,391.68
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First.

The inventoried value, made by Mr. Jagoe, approved by Mr. Hume, and verified by Prof. Jackson, after deducting the item of \$37,561.11, as found by the Master to be in excess of the value of the underground system, and deducting all overhead charges, leaving the "bare bones of the plant" is.....	\$1,587,447.55
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To this must be added:

Franchise.....	80,000.00
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"Overhead charges" as fixed by the defendant's own expert, and lower than any other witness.....	90,000.00
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No working capital, but merely supplies on hand
as fixed by defendant's own expert..... 18,000.00

Total valuation..... \$1,775,447.55

Nothing is included for "going concern" value

Second.

The Master says the plant cost..... \$1,381,124.41

He deducts 10 per cent for depreciation..... 138,112.44

Leaving the value of the plant..... \$1,243,011.97

We will presently show that the Master is in error in deducting this 10 per cent depreciation.

However, accepting his value of..... \$1,243,011.97
to this must be added overhead charges, which the
Master declines to recognize as a proper element of
value..... 90,000.00

Franchise value..... 80,000.00

Supplies..... 18,000.00

Working capital..... 33,353.15

"Going Concern" value..... 50,000.00

Total..... \$1,514,365.12

If we add the amount deducted by the Master for
depreciation erroneously on his own basis, as we shall
clearly show..... \$ 138,112.44

The result is a total valuation of..... \$1,652,477.56

Third.

And finally, the Court ascertaining the value of the
plant to be "at least"..... \$1,449,593.20

This is the "bare bones" of the plant.

To this must be added:

Franchise.....	80,000.00
"Going Concern" value.....	50,000.00
Total.....	<u>\$1,579,593.20</u>

It is confidently submitted that the value of the plant at the date the rate ordinance was adopted, excluding toll lines and real estate, was conservatively worth *at least* the sum of.....\$1,700,000.00

However, in view of the meager earnings, as will be shown, the cost and the value of the plant is immaterial. The earnings under the ordinance rates are not sufficient to earn 6 per cent on the *lowest* valuation insisted upon by any witness in the record, and will show a much lower per centum of earning on the valuation reported by the Master.

The Master was directed to report:

VI.

THE GROSS AND NET EARNINGS FOR THE YEARS 1905 TO 1908 INCLUSIVE.

As has been stated, 1908 is the most favorable year to the contention of appellant, and is most unfavorable to the contention of the appellee of the four years, 1905 to 1908, hence the earnings and expenses for that year alone will be discussed:

Before coming to the receipts and disbursements for that year, it is important to state the facts relating to the examination of appellee's records and original vouchers by the expert accountants selected by both appellant and appellee.

In his supplemental report the Master states:

"Complainant began its testimony in this cause by introducing as a witness Mr. H. Blair Smith, Auditor of the Complainant, and at the conclusion of his direct examination, counsel

for defendant moved "The Master for an order permitting defendant, through its accountants, to examine said books, records and accounts of complainant, and for an order directing and requiring complainant to make a full and complete exhibit, and show all its books and records to defendant's accountants." This motion was objected to by complainant, and the objections were sustained and the motion was disallowed.

"Thereafter at a conference between the Special Master and counsel representing both litigants, complainant's counsel submitted two propositions: One was that the Special Master should select an expert accountant who should examine the books and records of the complainant company, and make a report directly to the Special Master, and that this report should be treated as evidence in the cause by both parties.

"The alternative proposition was, that each party to the litigation should select an accountant, and that the two accountants thus selected should make a joint examination of the books and records of the complainant company, and should make a joint report to the Special Master upon all matters that they could agree upon, and as to all matters they could not agree upon, that each was to file a separate report.

"The defendant's counsel agreed to the latter proposition. It was then stated by the Special Master in the presence of counsel for both parties, that whatever these accountants should jointly agree upon, should be accepted as final by the Master, and no proof should be permitted to vary or contradict such joint findings. As I understood it, this statement was accepted by both parties.

"Upon an examination of the joint report, I find that the expert accountants agreed and so reported that the books of the complainant showed as to the cost of complainant's plant, and as to the expenditures for construction, as to the gross earnings and as to operating expenses. The report specifically states as to the foregoing matters as follows:

"The foregoing joint report shows the money charged as the cost of the plant at Louisville, the gross amount credited to the Louisville Exchange as earnings, and the operating expenses charged as appertaining thereto, as recorded on the books of the Cumberland Telephone and Telegraph Company. It is not an agreement that the said accounts are properly dis-

tributed or charged as we believe they should be, therefore the right is reserved by each of the undersigned to make such individual report and statement relative thereto as each may feel justified in doing."

"The only fact reported by the accountants to which both agreed, was as to what would be the probable loss in earnings the first year after the ordinance rates should be put into operation. Their finding was that such loss would be \$49,721.76. This fact I adopted in my report, and my calculations are all based thereon."

The Master reports that the *books of appellee* shows exchange operating expenses for 1908 to have been\$ 217,395.53

In this, the Master is clearly in error. The accountants made up a statement of *their own* from original vouchers and other information and stated the expenses to have been for the year 1908 the sum of\$ 217,395.53

The books of appellee showed the expenses to have been 227,495.66

The difference of \$10,100.13 is accounted for in two ways—\$3,707.34 is bad debts.

Appellee in keeping its books charges up all exchange earnings under the head of "Revenue." This is done because these charges are placed upon its books before it is known whether all these accounts can be collected. Thereafter, when it is ascertained that any accounts are uncollectible, they are charged as expense, which offsets a like amount of revenue. This is done because it is more convenient in keeping books.

The accountants in making up their joint report, knowing what revenue had been collected, stated the net revenue that had been collected by appellee, and, therefore, did not charge uncollectible accounts as an expense. The result to appellee is the same, and its books at the end of any given period would show larger gross earnings and larger expenses by the exact amount of uncollectible accounts, but the one would offset the other. The accountants have eliminated bad debts, both from the earnings and expenses, thus leaving earnings and expenses without being encumbered with uncollectible accounts.

The remainder of this difference, \$6,392.79, is accounted for in this way:

During the time the employes of the Mutual Audit Company, appellant's expert accountants, were examining the books of appellee, they had in their employ at Nashville, Tennessee, but *not* in the office of appellee, where they were engaged in their work, a man by the name of Settle, who had been for many years local cashier of appellee at its Louisville Exchange. He was a defaulter and had been discharged about September, 1908.

This witness occupied a desk in appellee's office at its exchange building in Louisville, on the first floor. He undertakes to give with great accuracy, during all of the time he was so employed, the exact amount of time various of appellee's employees spent in the Louisville Exchange, and the time spent by them elsewhere. He undertakes to give the time spent by the Superintendent of the Louisville Division in his office, although the Superintendent's office was on the next floor, and was entered by a door not connected with the floor on which Settle had his desk.

The Mutual Audit Company, having in its employ this young man Settle, deducted from the Louisville Exchange a part of the wages and salaries of the men named by Settle in proportion to the time Settle *said* they were in the Louisville Exchange compared with the time he *said* they were in other places.

It thus appears that these deductions were made from the expenses as entered upon the books of appellee, and as shown by the original pay rolls, *alone* upon the statement of a man who was a defaulter, and had, for this reason, been discharged from appellee's service, and who could not possibly know the facts.

As soon as these facts were developed in the evidence proof was introduced by appellees to show, not only that these deductions from its expenses were unjust, but that it was a physical impossibility for Mr. Settle to have any such knowledge as he claimed to possess, and upon which deductions of several thousand dollars per annum had been made from the expenses of conducting the Louisville Exchange.

Mr. Hume, the General Manager of the Company, makes the following explanation.

"The exchange, in addition to being under the general supervision of a district superintendent, has its local manager, its general foreman of plant or construction, its chief electrician, its chief operator, and the employes that work in these respective departments, and what is there is what would be found in the same size exchange, approximately the same size exchanges as at Nashville and Memphis, no more and no less. As to Mr. Settle's charge that there were men there who were giving one-fourth of their time or any other material part of their time to outside matters, he has made the charge without personal knowledge and without fact. The matter that he has gotten on his mind in a twisted manner is simply this: that in the development of the business around what we term the metropolitan district of Louisville, we have put in a number of small switching exchanges in various sections of the country, both in Kentucky and in Indiana, within a radius of twenty or twenty-five miles of the City of Louisville itself, and at each of these small exchanges we have employes to take care of the exchange and to give the service from the switchboard. In other words, at each of those switchboards we have exactly the force we would be compelled to have and that would be found in other small exchanges, even though they might be a hundred miles from any large exchange; but, on account of the fact that to all those exchanges and from all those exchanges there are certain subscribers who have arranged for Louisville service, and the further fact that all the subscribers of Louisville are given access to all these special subscribers in all these exchanges referred to, and given this service without any extra charge whatever in the way of tolls or additional monthly rate in their exchange, in the interest of their exchange, in the interest of the Louisville service, we allow the manager and the other supervising officers of the Louisville exchange to do whatever may be necessary in the way of supervising; in watching over the service at these smaller exchanges; but whenever it comes to any actual work, the employment of any of our linemen or troublemen or electrical men, or plant men, or material shipped to Louisville for the use of Louisville, every item and every minute of time employed by such employes is reported and the proper credit given on the Louisville account and proper charge made against these smaller exchanges that are not in every respect, and, in fact, a part and parcel of the Louisville plant."

Hume's dep., Trans., pp. 674-5.

Mr. Hume then shows how impossible it is for Mr. Settle to have been able to determine what portion of time any of these employes spent in or outside the Louisville Exchange.

Notwithstanding these facts, the accountants, who are merely bookkeepers, and did not know anything about the reasons actuating appellee's officers in charging up the expenses of Louisville Exchange as they did, have seen fit to deduct several thousand dollars each year from the expenses of the exchange which properly belonged thereto.

In this way the Master has by oversight understated the expenses for 1908 by _____ \$ 6,302.70

The actual expenses were _____ \$ 223,788.32

The gross earnings were found by the Master to have been _____ \$ 325,838.30

But the Master *increased* these gross earnings to _____ 369,087.00

This difference, \$43,248.70, is accounted for in this way:

Appellee is engaged in two kinds of telephone business. It has 517 exchanges. Each exchange is separate and distinct. Each is in a separate city or town. The patrons to any one of these exchanges have no concern with any of the other exchanges. The patrons to each exchange are charged a certain amount each month for the privilege of conversing with the other patrons to that exchange. His payment covers service to that particular exchange, and that particular exchange only undertakes to furnish service among the patrons paying for service to that exchange.

Appellee also operates a system of toll lines which extend from each of these cities and towns to many other cities and towns in the territory where appellee conducts its business.

The charge for the use of these toll lines does not depend upon whether the customer is a subscriber to an exchange or not. The charge for the use of the toll lines is the same for subscribers and

non-subscribers to the various exchanges. The *charge* for toll line use is for each time the toll line is used, and the *amount* of the charge is based upon the distance and the length of time the toll line is used.

To illustrate: Appellee has an exchange in Louisville and one in New Orleans. The Louisville patrons are charged so much per month for the privilege of conversation as often and as long as they may desire with any one or more of the other patrons of the Louisville Exchange. In like manner each patron to the New Orleans exchange pays so much per month for the privilege of conversing as often and as long as he may desire with any one or more of the other patrons of the New Orleans Exchange. The Louisville patrons have no concern with the New Orleans patrons, and the New Orleans patrons have no concern with the Louisville patrons.

There is a toll line from Louisville to New Orleans. Each subscriber in Louisville, and all other patrons in Louisville, equally and alike, may talk from Louisville to New Orleans to any patron or other person in New Orleans, and the charge for thus talking is the *same* to each person, whether they be exchange patrons or not.

In practice it has been found that exchange patrons in Louisville desire to talk over their lines from their residences or places of business, instead of going to a central station and waiting until they can be put into communication with the person desired at New Orleans. But the charge for talking to New Orleans is the same, whether the Louisville patron talks from his residence or place of business, or from the central office.

It is thus seen that the charge for exchange service is one thing, and the charge for toll line service is a wholly different thing. Exchange earnings belong to the exchange, and toll line earnings belong to the toll lines.

The construction of toll lines is kept separate and distinct from exchange construction. They are separate and distinct properties.

If this were all there could be no confusion; the *earnings* of the exchange and the toll lines are separate and distinct, and the one bears no relation to the other.

However, the separation of exchange and toll line *expenses* is not so distinct, for these reasons:

The Louisville patrons to the exchange service not only desire to converse with each other, but they desire to use the toll lines from their residence or places of business, hence the exchange is connected with the toll lines, so that patrons may talk over the toll lines without leaving their places of business or their residences. This is a very great convenience to the exchange patrons, since they may notify the operator of the exchange whom they wish to talk with in New Orleans, and while the New Orleans party is being looked up, the Louisville subscriber goes ahead with his business, and when the New Orleans party has been located, the Louisville patron converses with him, and has lost neither time nor effort in going to the central office. But the *charge* for the talk is distinct from the charge for the exchange service.

The exchange employes have done two things. They have answered the exchange patron, and have also helped to operate the toll line from Louisville to New Orleans. How then shall this expense be divided? Every one agrees that some of this expense should be borne by the toll line, and some by the exchange. Since the same employes perform both kinds of service, it has been found impracticable to accurately separate this expense. There is no difficulty in separating the *receipts*, but to separate the *expense* of operating has been found to be impracticable.

Experience has shown that if 15 per cent of the toll line receipts are given to the exchange, for the service performed by the exchange, the exchange will be sufficiently compensated for its services to the toll lines. This 15 per cent is the amount appellee receives at its exchanges for handling toll line messages for *other* companies, and is for the amount the owners of exchanges handle toll line messages for appellees.

This being the amount agreed upon by parties dealing at arms' length, establishes the justness of the division. Therefore, when it becomes necessary for appellee to separate the operations of one of its exchanges from the operations of its toll lines, it makes the division on the *same* basis as is made between it and other companies in these contracts.

All this is made clear in the record, and is fully discussed in our exceptions to the Master's report. (Supplement to brief, p. 90.)

The Master did not think 15 per cent of the toll earnings sufficient compensation to allow the exchange, and he thereupon gave the exchange 100 per cent of the toll line earnings, thus destroying *all the benefits of owning toll lines*.

It must be noted that this a theory of the Master's alone. No witness makes any such claim, and there is nothing in the record from which such a conclusion can be drawn.

The Master seems to think that it really makes no difference to complainant since it owns both the exchanges and the toll lines. It might as well be said that since appellee owns both the Louisville Exchange and the New Orleans Exchange, that it makes no difference to appellee if the receipts of the New Orleans Exchange be credited to the Louisville Exchange. And so it would not in one sense. But it makes a very *vital* difference when the inquiry is, What are the earnings of the Louisville Exchange?

In any inquiry as to what are the receipts and disbursements of the Louisville Exchange, receipts from other exchanges, toll lines, stocks, bonds, and *all other* sources must be excluded, *although* all these other properties may belong to the owner of the Louisville Exchange.

It thus appears that the Master has by an obviously erroneous theory of his own, *increased* gross earnings by \$43,248.70. This one error was sufficient to change the Master's report in favor of the ordinance rates.

The result is, that for the year 1908, the gross earnings of the Louisville Exchange were	\$ 325,838.30
Expenses actually paid	223,788.32
Leaving <i>apparent</i> net earnings of	\$ 102,049.98

It is conceded by every one in the record that the ordinance rates would have reduced earnings \$ 49,721.76

This would leave net earnings for 1908, if the ordinance rates had been in effect. 52,328.22

As will be pointed out hereafter, the Master allows for depreciation, maintenance and repairs, for the year 1908	92,449.45
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There was actually expended in 1908, the sum of.....	86,155.98
a margin of \$6,293.47, which must be added to expense,	
and which reduces net earnings to	46,034.75

His Honor, the trial Judge, out of an abundance of caution, allowed 25 per cent of tolls as exchange earnings, instead of 15 per cent. The trial Judge also allowed the item of \$6,392.79 discussed *supra* p. 29 and in this way ascertained net earnings for 1908 to have been

	96,262.11
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If from these net earnings, as found by the Court, there is deducted the reduction that would result if the ordinance rates had been in force, \$49,721.76, the real net earnings as found by the Court for 1908, are

	46,540.35
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The Master found net earnings for 1908 to have been	\$ 150,673.19
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From this must be deducted

85 per cent of tolls	\$ 43,248.70
As shown on p. 29 <i>supra</i> , the item of	6,293.47

Total	\$ 49,542.17
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Leaving the Master's net earnings	101,131.02
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From this must be deducted the reduction under the ordinance rates	49,721.76
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The Master's net earnings for 1908 are	51,409.26
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It thus appears that when the obvious errors of the Master's report are corrected, his finding as to net earnings for 1908, under the ordinance rates, corresponds very nearly with the findings of the trial Judge, and with the insistence of appellee.

Net earnings for 1908 on appellee's insistence, are	\$ 46,034.75
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The finding of trial Judge	46,540.35
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The Master's finding after correcting manifest errors,
are \$ 51,409.26

No one will insist upon a valuation of *less* than \$1,200,000.00. It is thus seen that the ordinance rates will not permit a return of even 5 per cent upon the lowest valuation that can even be contended for.

As was said above, the valuation of the plant is of no importance because of the very meager earnings allowed under the ordinance rates.

The Master was directed to report what amount should be set aside for:

VII.

DEPRECIATION.

The Master finds that seven per cent per annum upon the value of the plant (excluding cash working capital and supplies) is a proper amount to set aside each year for depreciation.

But when the Master comes to apply this depreciation fund, he erroneously includes as depreciation, all current repairs, which is not depreciation in any sense; current repairs adds nothing whatever to value of the property, and does not renew or reconstruct any part of the property.

That depreciation and current repairs are separate and distinct things, is shown in *Knoxville vs. Knoxville Water Works Co.*, 212 U. S. 13, where it is said:

"Before coming to the question of profit at all, the company is entitled to earn a sufficient sum annually to provide, not only for current repairs, but for making good the depreciation and replacing the parts of the property when they come to the end of their life."

Two things are apparent from this quotation. The first is, that current repairs is one thing and depreciation another thing, and the second is, that depreciation is an expense of conducting the business as much so as operating expenses, and whatever depreciation is allowed, must be added as expenses of the business.

Depreciation is not repairing or maintaining the property or plant in an operating condition. Depreciation is intended to care for silent decay, changes in the art brought about by the evolution in the business, changes required in shifting parts of the plant, owing to action of the municipal authorities, and unknown but certain disasters which come in a cycle of time.

There is another expense of operating a telephone plant which is not connected with in any way the *depreciation* of the plant, and that is *maintaining* the property in an operating condition, and called "current repairs," "operating maintenance," "maintenance repairs," or merely "maintenance."

Depreciation does include reconstruction, and, in addition, embraces evolutions in the art requiring the replacement of parts of the plant that have not worn out, but are replaced because of the discovery of newer and better apparatus and appliances; and, also, as stated, shifting of plant on account of the necessities of the city, and unknown disasters, or losses, that always come within a cycle of time, and must be provided for out of earnings.

There is no confusion in the record among the witnesses as to "maintenance" and "depreciation."

Mr. Caldwell, appellee's President, states:

"Depreciation covers—in other words, when I am considering depreciation and when I am discussing it, it covers quite a wide field. Not only is contemplated the wear and tear that is not observable, or that does not require immediate attention, but it also contemplates the changes in the art, the evolution that has gone on and is going on continually, and the unknown dangers and hazards that are likely to come up and are sure to arise in some form, not at stated intervals, and not, perhaps, frequently, but will arise in some form or other and call for extraordinary expenditures. That, I say, is the field that I have before me when I am considering the question of depreciation, and the necessity to provide therefor is imperative. As to how it may be treated, or how it may be kept, it is a subject that will vary and has varied with different people in different lines of business, but whether it is reckoned within the accounts or not, does not alter the fact that the force is working its way all the time, and that it will have to be reck-

oned with inevitably. In other words, it is a force that is not dependent upon the whims or idiosyncrasies or opinions of individuals. They are entirely above and beyond any such influences."

Caldwell's dep., Trans., vol. I, p. 838.

And again, in reply to a question by the Master, he explains the difference between depreciation and maintenance as follows:

"If a brick—if something should fall off of this house, a brick or something, and break our route in two there, men would go there to repair that. The cost of doing that would be Incidental Repairs, and it would go into Maintenance, but it would not be that class of expenditure which would be counted as a thing to perpetuate and renew the property. Now, then, all that class of expenses, if it had gone into Maintenance, would have to be taken out and excluded before you made up the amount that would represent what you term the equivalent of seven and a half per cent. (Depreciation.)"

Caldwell's dep., Trans., Vol. I, p. 841.

Mr. Crumb, one of the city's expert engineers, says:

"Assuming there are ten thousand telephones and operating, general and maintenance expense of \$150,000, *there should be added to those expenses the sum of money based upon the actual cash investment in the plant sufficient to cover the depreciation.* Taking the actual cash investment in the plant at approximately one million dollars, and figuring depreciation at seven per cent would be \$70,000, which should be added to the \$150,000, making \$220,000, which it would be necessary for the telephone company to earn to cover the actual cost of operation, maintenance, general expense and depreciation."

Crumb's dep., Trans., vol. II, p. 904.

Mr. Levings states that:

"In figuring the expense of operating a telephone plant, you must allow for depreciation, operating, maintenance and general."

Leving's dep., Trans., vol. II, p. 1534.

Mr. Polk says that:

"In operating a telephone plant, you must allow for general expensés, operating expenses, maintenance expenses, and, in addition, depreciation."

Polk's dep., Trans., vol. II, p. 1418.

It thus appears that the treatment by the Master of depreciation is erroneous, and his findings as to any return for the year 1908, are based upon an erroneous conclusion.

That depreciation is necessary is shown.

First—By the decision of this Court.

Second—By the treatment of the matter by the experts and scientific writers on the subject as revealed in this record;

Third—By every witness who speaks of the matter in this record.

While the Master says that he allows seven per cent for depreciation, and at the same time includes all current repairs as a part of his allowance for depreciation, yet, when he comes to apply even this principle to the operation of complainant's plant, he does not allow, in the expenses for 1908, the amount he says is proper, *including all current repairs*.

The Master allows for current repairs and depreciation for the year 1908, the sum of \$94,606.83; he then states the amount actually expended by appellee for maintenance and reconstruction for 1908 to have been only \$86,155.98, which makes a difference between the amount allowed by the Master, and the actual amount expended by appellee on reconstruction and maintenance during 1908, \$8,450.85. The Master then does allow \$2,050.74 in addition to the amount actually expended by complainant, whereas, he should have allowed the difference between the amount stated by him to be a proper amount for depreciation, and the amount actually expended, which was \$8,450.85. The difference between the amount allowed, \$2,050.74 and \$8,450.85 is \$6,400.11. So that really, upon the Master's own theory, his net earnings for 1908 should be reduced by \$6,400.11.

It must be apparent then that the only inquiry in this case is as to what amount should be allowed for depreciation. All the witnesses agree that there should be *some* amount set aside for depreciation. The Master also finds that there should be some amount, and he fixed it at seven per cent, but the Master misapplies the entire principle of depreciation by including as a part thereof the amount expended on current repairs.

The three witnesses of the defendant allow for depreciation, as follows: Mr. Polk, \$50,000 per annum; Mr. Levings, \$50,000 per annum; and Mr. Crumb, seven per cent upon the cost of the plant, which on his basis would be about \$70,000. The Chicago Commission allows 8.03 per cent upon the value of the plant, including buildings. Appellee's witnesses place the amount at from seven to seven and one-half per cent upon the cost of the plant, excluding real estate. So that it appears that the lowest *amount* allowed by any witness for depreciation on this plant is \$50,000 per annum.

It appears that for the year 1908 appellee expended on reconstruction \$31,000, so that the net amount to be set aside for incomplete depreciation is \$19,000, assuming that \$50,000 is the proper amount. If this should be applied to the Master's net earnings for 1908, they would be further reduced by this \$19,000.00.

But the fallacy of the Master's application of depreciation may be shown in another way. The purpose of ascertaining what amount is necessary to be set aside for depreciation is predicated upon the assumption that *all* depreciation is not cared for as it occurs, and *some* amount must be set aside out of earnings each year, to be expended in future years, when the time for renewal arrives. If depreciation could be cared for each year, there would be no necessity to inquire into the question of depreciation at all; the only inquiry would be to ascertain what amount had actually been expended each year, just as operating expenses are ascertained.

The Master finds 7 per cent on the value of the plant is the proper amount to allow for depreciation. On this basis, he finds that the amount for depreciation is:

1905.....	\$	86,818.77
1906.....		93,457.53

1907.....	\$94,914.66
1908.....	94,606.83

The Master also finds that the amounts *actually expended* on maintenance and reconstruction (both of which he says is depreciation) were:

1905.....	\$ 90,870.36
1906.....	93,423.00
1907.....	107,511.41
1908.....	86,155.98

It thus appears that in four years appellee actually expended on maintenance and reconstruction \$ 377,960.75

While the Master only allows for depreciation and maintenance during these same years \$399,797.79

It is thus seen that the Master allows \$8,162.96 less for depreciation than was *actually expended* during the same four years.

The Master not only does this, but says that the plant has depreciated 10 per cent in value beyond what has been expended in caring for depreciation. The result is: A plant has had expended on it \$8,162.96 *more* in four years than was necessary to care for all depreciation, and yet has depreciated 10 per cent in value. The two propositions cannot stand. One or the other is *wrong*. The Master must either allow *more* for depreciation, or find that the property has *not* depreciated at all.

While the Master states that the plant has depreciated 10 per cent, after having had spent on it *more* than he finds necessary to care for *all* depreciation, he says:

"The witnesses for complainant all agree that the plant has been kept up in excellent condition."

"It (the plant) is in excellent condition."

"The service rendered by complainant is good, and the physical condition of its plant is excellent."

That the two propositions of the Master cannot stand together is certain. Which shall yield? Shall the \$138,112.44 deducted from the value of the plant for depreciation in value be restored, or shall there be allowed a *larger* amount from earnings from a depreciation fund?

Having discussed depreciation and its treatment by the Master, we will now show the results, if the Master be correct in his treatment of this subject.

The Master states net earnings for the year 1908 to be	\$ 150,673.19
In this is included all toll earnings.	
The ordinance rates would reduce this amount.....	\$ 49,721.76
Real net earnings, under the ordinance rates, including all toll receipts.....	100,951.43

But the Master says the property has depreciated 10 per cent. This depreciation is an expense of conducting the business, as every one agrees.

Therefore, this expense must be taken out of earnings before net profit is ascertained. The amount of depreciation found by the Master is \$138,112.44 for the nine years from 1900 to 1908, inclusive. The same amount must not be taken out of each year's earnings, because there was three times as much property depreciation in 1908 as there was in 1900. The Master states there was only \$457,579.07 in 1900 and that in 1908 there was \$1,381,124.41 of property. So that the proportion of this \$138,112.44 to be taken out of 1908 earnings is at least.....

\$	20,000.00
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This deducted from net earnings for 1908 reduced by the ordinance rates, and including all tolls, leaves real net earnings for 1908	80,951.43
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The Master allowed for depreciation, including all current repairs, for 1908, \$94,606.83; but when he comes to state net earnings, he only allows \$86,155.98 actually expended that year, plus \$2,050.74, or \$88,206.72; or a difference of.....

6,400.11

On the Master's own theory, this was a part of the expenses for the year 1908, and must *reduce* the Master's net earnings, on his own theory, to.....\$ 74,551.32

This amount is only 6 per cent on a valuation of..... 1,242,522.00

The depreciated value of the plant by the Master is.. 1,243,011.97

This valuation excluded franchise, working capital and "going concern" value.

If the Master is correct in his allowance for depreciation, his valuation must be increased..... 138,112.00

If the depreciation found to be necessary by the Master is properly applied, the earnings for 1908 will be reduced to practically nothing.

SUMMARY ON EARNINGS FOR 1908.

Mr. Farnham, appellant's expert accountant, found net earnings for 1908 to have been 151,612.74
but he concedes that he has not included in expenses \$31,450.07 actually expended that year, under the specious plea that this amount should be charged to "reserve," and yet he nowhere creates any reserve out of earnings to which this expense, actually occurred, could be charged.
So that Mr. Farnham's net earnings for 1908 are 120,162.67

The earnings also include the item of \$6,293.47, expense actually incurred in 1908, but which was taken out of the expenses under the advice of Mr. Settle, as shown *supra* p. 29. So that Mr. Farnham's *actual* net earnings for 1908 are 113,869.20

This does not allow *any amount for depreciation.*

The Master found net earnings for 1908 to have been... 150,67.19

But the Master includes *all* toll receipts, when he should have included only 15 per cent, as has been shown *supra*, p. 31. The excess amount of tolls included by the Master is..... \$ 43,248.70

His findings also includes the item of \$6,293.47, which is erroneous, as shown *supra*, p. 29.

The Master's *real* net earnings for 1908 are..... 101,131.02

This does not *allow any amount for depreciation*.

The real net earnings, as stated by appellee's auditor, for 1908, were 100,719.03

This does not *allow any amount for depreciation*.

The record clearly shows that 7 per cent per annum on the value of the plant, excluding real estate, supplies and working capital, is the proper amount to set aside from earnings for depreciation, and the Master so reported, and no exception was taken thereto by appellant.

If we adopt, for the argument, the Master's valuation of \$1,243,011.97, the amount to be allowed for depreciation, would be \$87,010.83. The actual amount expended on depreciation in 1908, according to the joint report of the accountants, was \$31,450.07. The net amount to be set aside out of earnings for 1908 was, therefore..... \$ 55,560.76

This amount, taken from the *apparent* net earnings as shown above, leaves

Mr. Farnham's net earnings	\$ 58,308.44
The Master's net earnings	45,570.26
Appellee's Auditor's net earnings	45,158.27

The reduction in the rate ordinance would have been \$49,731.76. If, therefore, the ordinance rates had been in effect in 1908, the greatest net earnings reported by any one would have been only..... \$ 8,576.68

VIII.

THE FAIR VALUE OF THE SERVICE

In the leading case on rate regulation, the Supreme Court says, that two things must be considered, the rights of the owner of the property, and the rights of its patrons. The owner's rights require a reasonable return on "the fair value of the property used for the public," and the patrons' rights require that the charge be for "the fair value of the services rendered."

Smyth vs. Ames, 169 U. S., 466.

This principle runs through all the cases reported since that decision was made.

The practical way of guarding the rights of the owner to a reasonable return, and the rights of the patrons to be only charged for the fair value of the service, has been to ascertain "the fair value of the property used for the public," and then to require the patrons to pay such charges as may be necessary to pay all expenses of conducting the business, and in addition whatever may be necessary to preserve the integrity of the property, and then a reasonable profit to the owner of the property. It has been justly said that usually this test demonstrates that the patrons are only charged for "the fair value of the services rendered." Sometimes it happens that a property is so situated that the charges are more than "the fair value of the services rendered," *although* the charges do not yield to the owner a reasonable profit, as was shown in the case of

Covington Turnpike Co. vs. Sanford, 164, U. S., 596.

The converse of the proposition must also be true. We submit that the case at bar is clearly one of that character.

The evidence shows that the Louisville Exchange subscribers have the use, without additional charge, of the exchanges at Jeffersonville and New Albany, Ind. They also have free service to certain subscribers to the following exchanges located in Jefferson County:

	Number of Subscribers.
Anchorage.....	42
St. Matthew's.....	63
Jeffersontown.....	36
Harrods Creek.....	42
Pleasure Ridge Park.....	41

No part of the "fair value" of any of these exchanges is included in the valuation of the Louisville Exchange, and no part of the expenses of operating these exchanges is charged against the Louisville Exchange.

Trans., p. 226.

The Master has *even* charged against these exchanges a *part* of the expenses of the Louisville Exchange. So that the Louisville Exchange patrons get free service to these outside exchanges, and pay not one cent for the service, and *yet* these exchanges are made to bear a *part* of the Louisville expenses.

Supra, p. 29, Supplement to brief, p. 103.

The contention of the Master is inconsistent. If the Louisville patrons receive free service to these other exchanges, they should bear a part of the expenses of these other exchanges, and it would be proper to include a part of the value of these other exchanges. But the Master not only does not include any part of the value of these exchanges, nor any part of the expenses of these exchanges, *but* actually makes these other exchanges bear a part of the Louisville Exchange expenses.

If we concede, as we do, that no part of the value, and no part of the expenses of these other exchanges, shall be included in the value of the Louisville Exchange, we clearly have the right to insist, as we do, that the Master should *not* have taken \$6,392.79 of expenses for 1908 from the Louisville Exchange, and thereby *increased* the apparent net earnings that amount.

Appellant insists that the patrons at these five exchanges in Jefferson County pay a higher price for Louisville service, but the Louisville patrons do *not* pay anything additional, and the inquiry is whether the Louisville patrons are charged a reasonable amount

for the service rendered *them*. The questions of what other patrons, *somewhere else* pay, is not involved. It is a question of what the patrons inside the *corporate limits of Louisville* pay.

Under any view of this matter, the facts disclosed should resolve all doubts as to value and earnings of the Louisville Exchange in favor of appellee.

IX.

EXPERIENCE UNDER EXISTING RATES ACCURATELY FORECASTS THE FUTURE, UNDER LOWER RATES.

A reduction in rates does not reduce expenses. This is self evident, and is conceded to be true by all the writers on the subject, by all the witnesses in this case, and is recognized as true by this Court

The only possible way in which net earnings are ever increased in any kind of business, under reduced rates, is that the larger volume of business yields a larger aggregate net profit.

A gas company may charge \$1.00 per thousand for gas, and if the rate is reduced to 80 cents, there may be an *increased* consumption by the same and new patrons. But for such *increased* consumption, the patrons pay an *increased* sum. In this way the net profits to the company *may* be increased, on account of the *increased* volume of business.

But with the telephone exchange operating on "flat rates," the patrons *pay less* and certainly use *no less* service. If the gas company charged \$5.00 per month for whatever gas a patron desired to consume, a reduction to \$4.00 per month could not possibly *increase* the net profit to the company. It would be certain that the company, while possibly not supplying *more* gas, would receive *less* for what it did supply. The company would only receive \$4.00 instead of \$5.00 even though the patron used the same amount of gas as he did when he was charged \$5.00. But even in *this* case, the *new* patrons at \$4.00 per month *might* increase the volume of business to *where* the *increased* volume of business, even at \$4.00 per patron, would yield a larger aggregate net profit.

With the telephone exchange, if the patrons are charged in the aggregate \$100,000 for service, a reduction to \$50,000.00 could not possibly *increase* the profit. The patrons would receive the *same* service, and pay one-half the price; and if the patrons to the telephone exchange *increase*, two things happen, the old patrons use *more* service and pay *less*, and the expense of serving the *old* patrons *increases*. This is true because the telephone exchange is not *selling* a *commodity*, but is *furnishing facilities*. When *new* patrons are obtained, *new* facilities must be furnished, and the old patrons *retain* the *same* facilities they had before the new patrons were obtained with an *added expense* of re-arranging the facilities of the *old* patrons so they may be put into connection with the *new* patrons, and in like manner, the facilities furnished the *new* patrons costs more, because they must be arranged so the new patrons may be put into connection with the *old* patrons; and when all this has been done, each patron, both the old and the new, use *more* service, and pays *less*. See Trans., p. 552.

And so it is, if the charge to existing patrons under the new rates, is not remunerative, the *same* charge for an *increased* number of patrons, cannot *possibly* be remunerative.

This has been the experience of the entire country. In New York, the largest telephone exchange exists. The price for service was \$20.00 per month. It had to be abolished, and measured service established, that is, a charge for each time a patron uses the telephone. As the size of the exchange decreases in small cities, the charge *decreases*, until we find the *smallest* charge for exchange service in the *smallest* towns and cities.

This results from the fact that *each* patron is charged a fixed sum per month for all the service he desires.

When we look at the experience of other public service concerns such as gas, water and electricity, we find the very reverse to be true. Leaving out of mind abnormal conditions, which exists here and there throughout the country, we find that the charge for gas, water and electricity is *higher* in the smaller cities and towns, and *lower* in the largest cities and towns.

This subject has been fully discussed in our exceptions to the report of the Master (supplement to brief, p. 156.) But we submit the following as being sufficient, in view of the fact that there is no conflict in the record and *all* the witnesses agree that this principle is sound and undisputed:

In *Louisiana R. R. Commission vs. Telephone Co.*, 212 U. S., 426, the Court says:

"We say this because the evidence shows that in case of telephone companies the general result of a reduction in rates in some other kinds of business does not follow, namely, that there would be an increased demand, which could be supplied at a proportionately less cost than the original business. Such, it is admitted, would be the case generally in regard to water companies, gas companies, railroad companies, and perhaps some others, where the rate is a reasonable one. For example, it is said that it would cost no more, or certainly scarcely an appreciable amount more, to haul a train of two cars half filled, than it would to haul the same train with both cars half filled, and if the reduction in rates should result in filling the cars where previously they had not been half filled, there might be an increased carriage at a cost very little more than before, and probably an increased profit. So, in the case of a water company, the reduced rate might result in furnishing more water to consumers already existing, and the increased cost of furnishing same would be infinitesimal, where there was a supply sufficiently large to fill the demand. So, also, in furnishing gas at reduced rates, the reduction in the rate would very probably result in increased consumption, not only in increased demands from more consumers, but also an increased consumption by consumers already existing, and the increased cost of furnishing the gas would be nothing like in proportion to the increase in consumption. In these cases increased profits might be the result of decreased rates. But with telephone companies, as shown by the testimony of the president of complainant, the reduction in toll rates does not bring an increased demand, except upon the condition of corresponding increase in expenses."

In the report of the Committee to the City Council of Chicago, September 3, 1907, it is said:

"The average person does not understand why it costs more per telephone to supply telephone service in a large city than in a small city. The assertion of this principle to many seems a

paradox. It is regarded as contrary to the ordinary principle of business—that is, that the unit cost becomes less as the volume of business done increases. It is but natural to think that the wholesale principle ought to apply in the telephone business as in other lines. The idea prevails because the ordinary individual does not understand the peculiar features of the telephone business, and does not look beyond the telephone on the wall or on the desk. He does not take into consideration that the real business of a telephone is to furnish service, transmit messages, and not merely to rent instruments. This prevailing idea has constantly been brought home to the members of this committee by having their attention called by people thus uninformed to the lower rates existing in other cities; cities between which and Chicago there can be no common basis of comparison. Attention is called to some of the reasons for this exception to that rule of business, so well established."

Mr. Polk, appellant's main witness, says that an increase in the number of subscribers to the exchange would result in an increased capital account, and that it would result in an increase in all expenses of conducting the business; *that a reduction in rates would not reduce the expenses at all*, but that an increase in patronage would increase the expenses per station to a certain point.

Polk's dep., Trans., vol. II, p. 1439.

The Chicago Telephone Commission says:

"It is tradition in telephone circles that the service per telephone costs more as the number of telephones connected with the plant increases. As the number of telephones increases, each subscriber has the opportunity to call upon more people by telephone, and the law of averages would indicate that the number of calls per day from each telephone should increase, thus making the service more expensive to the operating company, provided the service is flat rate service and unnecessary use of the telephone is not deterred by a measured rate charge. This condition seems to have worked out in practice, according to the statements of telephone companies at Cleveland, Indianapolis, and elsewhere, and flat rate service seems to increase in cost per telephone as the number of telephones attached to a system increases."

Trans., Vol. I p. 826.

And, finally, the sworn answer of the defendant avers:

"Defendant admits that the value of the service increases as the number of subscribers increase; admits that as the service increases, the expense of conducting the business increases, but denies that each additional telephone involves additional capital."

There is one witness in the record, who has had actual experience in dealing with telephone rates in the City of Louisville, whose testimony is of more service in solving this problem than the theories and opinions of witnesses who have not had experience, however skilled they may be.

Mr. Caldwell, appellee's President, says:

"We have tried and experimented with every conceivable class and kind of rates and every theory of rating that those that were best qualified to talk on the subject, have suggested, we have tried, and our experience there was that every one of them proved disastrous, disappointing and a failure. In other words, we had poorer results, until this last series of rates which we inaugurated some two years ago—they show a betterment of conditions, the others all showed worse, so that it was not a matter of theory, but it has been a matter of actual experience with us in the City of Louisville."

Caldwell's dep., Trans., Vol. I, p. 513.

Mr. Polk states that is a *mere gamble* as to whether the rates prescribed in the ordinance are remunerative, *even* in a plant *only* costing \$1,300,000, including real estate.

Polk's dep., Trans., Vol. II, p. 1449.

The Master was directed to report:

X.

A FAIR RETURN TO THE OWNER OF THE PROPERTY.

What return is the proprietor of a telephone exchange entitled to receive for the use of his property by the public?

This question can be answered but one way on this record: the amount is 10 per cent upon "the fair value of the property devoted to the public use."

The Master in his report says:

"But it is insisted that unusual risk and hazards attend the telephone business, and that on account of these hazards a greater return on the money invested should be permitted by the rate-regulating powers. It is urged that new capital must be continually put into this business, so that its lines and operations may be commensurate with the growth of the cities where they are located; that otherwise, the business must come to a standstill, and new companies will enter the field and take the new business offered and perhaps the old business. It is urged that eight per cent or perhaps ten per cent on the money invested would, therefore, be a fair return."

Mr. Caldwell, the President of the company, says:

"The whole question comes right there. Unless the company is on a profitable basis, and is doing business that is profitable, it has no credit, and it is necessary for it to have credit. Therefore, in order to attract new capital must present sufficiently attractive profits to cause people to put their investments in the telephone business rather than in some other line of business, and, of course, unless it can show a profit in the business, it cannot possibly influence or attract capital to it. That is the key to the whole financial problem."

Caldwell's dep., Vol. I., p. 514.

Mr. Polk, the defendant's expert witness, says that a telephone property is entitled to *at least* 10 per cent net profit.

Polk's dep., Vol. II., p. 1436.

The Chicago Committee recommended, and the Council approved, a net return to the Chicago Telephone Company of 10 per cent.

A committee of the New Orleans Board of Trade, who are shown to be business men of the highest character, after investigating telephone conditions in that City, approved a net return of 10 per

cent, and in their report they quote with approval the following taken from the telephone report of the Merchants Association of New York:

"The telephone business demands a continuous accession of fresh capital to satisfactorily serve the public. Having in view the importance to the public of constant improvement and expansion and the greatest possible efficiency of telephone service, as well as the necessity of offering an attractive investment to new capital actually and necessarily invested and a proper allowance for contingencies, 10 per cent margin above operating outlays is a reasonable and proper margin in the telephone business. In the various movements hitherto made for the limitations by law of telephone profits, wherever the permissible percentage of profit has been dealt with, this margin has been accepted as a proper one. It has also been specified by law in the case of some other public service corporations."

Trans., Vol. I, p. 495.

This question is fully considered in our exceptions to the Master's report (Supplement to brief p. 162).

The Master does not appear to think that unforeseen and unknown contingencies will ever arise in operating appellee's plant in Louisville. It is a well known fact that no corporation or individual can afford to live up to the last cent of income; *something* must be set aside for contingencies, and even though a company be allowed to pay in dividends 8 per cent, it must be allowed to earn at least 2 per cent additional, because, as time goes on, it is certain that expenses of an extraordinary nature will arise that must be met; so that, unless provision is made each year out of the earnings to provide for these contingencies, disaster is certain to follow.

In the case of *Wilcox vs. Consolidated Gas Co.*, 212 U. S., 49, this Court said that the most favorably situated Gas Company in America, entirely freed from all risk of competition, with a *certain* patronage, and a business as stable as can be conceived of, was entitled to a net return of 6 per cent *in order to escape the charge of confiscation*. That is to say, any regulation of its rates, which did not allow a profit of 6 per cent would be confiscation.

We quote from an opinion of the Wisconsin Railroad Commission, delivered in 1910, in which a gas plant was allowed $7\frac{1}{2}$ per cent net return, and an electric light plant 8 per cent.

The Commission says:

"In passing upon these matters, however, it should be borne in mind that under present industrial conditions the best interests of society, as a whole, are subserved when the share of each factor of production is high enough to cause a free and unrestricted flow of labor, capital and business ability into the various utilities. If wages, interest and profits are not high enough to attract the factors which they represent, then these factors will not enter the utility business. The result of this is clear. If either or all of the factors refuse to enter this field, then no service of the kind these utilities render will be furnished, and the people may have to forego what may have become necessities to them. In order to obtain such service, therefore, it is absolutely necessary that the wages paid should be high enough to attract competent workmen, superintendence and management; that the interest paid on the capital legitimately invested should be sufficient to attract the necessary capital into these enterprises; and that the speculative and other gains should be high enough to induce employers to enter these industries as co-ordinators of the other factors of production therein, and as assumers of all risks and responsibilities that are involved in their operation. From these facts there is no escape. From this it also follows that the rates fixed for the services rendered by such utilities must, in the long run, be high enough to attract the various factors of production, or to induce the employer to enter upon such enterprises and to become responsible for the risks that are involved."

In the report of the Railroad Securities Commission to the President, dated December 11, 1911, the Commission, in speaking of what constitutes a reasonable return, says:

"We hear much about a reasonable return on capital. A reasonable return is one which under honest accounting and responsible management will attract the amount of investors' money needed for the development of our railroad facilities. More than this is an unnecessary public burden. Less than this means a check to railroad construction and to the development of traffic. Where the investment is secure,

a reasonable return is a rate which approximates the rate of interest which prevails in other lines of industry. Where the future is uncertain the investor demands, and is justified in demanding, a chance of added profit to compensate for his risk. We cannot secure the immense amount of capital needed unless we make profits and risks commensurate. If rates are going to be reduced whenever dividends exceed current rates of interest, investors will seek other fields where the hazard is less or the opportunity greater. In no event can we expect railroads to be developed merely to pay their owners such a return as they could have obtained by the purchase of investment securities which do not involve the hazards of construction or the risks of operation."

Surely, in a hazardous business, with active competition, subject to so many more risks than a gas property, 10 per cent should be allowed, in order to escape the charge of confiscation.

We therefore confidently submit that 10 per cent net earnings is not only not unreasonable, but is necessary in a business of this kind.

XI.

APPELLANT'S EXCEPTIONS TO THE MASTER'S REPORT.

Appellant excepted to the Master's report in four respects only.
Trans., vol. I, pp. 198-203.

First—The expenses for the year 1908 (omitting other years) were reported by the Master \$11,883.76 more than should have been reported.

Second—That all free telephones and reduced price telephones for charity and other public causes, should have been charged at the regular rate and the difference added as additional earnings, amounting to \$9,900.00.

Third—That the Master should have found and reported that instead of there being a loss in the year 1908 of \$49,731.36 if the ordinance rates had been in force, he should have reported that if the ordinance rates had been in force, the earnings of the company for 1908 would have been \$5,793.00 more than the earnings were under the higher rates which were in force.

Fourth—That if the *lower* ordinance rates had been in force during the year 1911 the net earnings of the company would have been probably \$30,000.00 *in excess* of what they were under the *higher* rates in force during that year.

In no other respect did appellant except to the Master's report.

Appellant appears from these exceptions to believe that lower rates will yield a larger proportionate net revenue than higher rates. This is only a theory advanced by appellant, and is not only not sustained by any witness in this record, or any writer upon the subject, but is disproved not only by appellee's witnesses, but by appellant's witnesses as well as the scientific writers on the subject.

This question has been fully discussed, *supra*, p. 47, and in our exceptions to the Master's report (supplement to brief, p. 156.)

With respect to the contention of appellant that all telephones furnished at a reduced price should have been reported as earning the full price charged patrons generally, we can only say that a statement of the facts is sufficient refutation of this contention. (1) It appears that certain of the employees of appellee in Louisville are furnished telephones without charge, or, at a reduced price. This, of course, is not only customary, but is necessary to enable the employees to render an efficient service to appellee's patrons in the city. (2) Certain charitable institutions and ministers of the gospel are furnished telephones at a reduced price. It is inconceivable that any public service corporation can conduct its business in any civilized community and not yield more or less to the demands of the public for some aid in caring for the charities of that community. Indeed, the failure to yield to this demand would very speedily entail upon the public service company a far greater loss in the animosities that would be engendered in such harsh and uncivilized conduct. Among other charities involved in this criticism of appellant is a free telephone in the newsboys' home. While it would be illegal for appellee to subscribe to a fund for the uplifting of this class of boys in the city, yet it is not illegal, and ought not to subject appellee to criticism, to furnish free telephone facilities to this charity. Congress and most of the States have recognized that public service corporations must of necessity allow their facilities to be used more or less in charitable

educational and benevolent undertakings. The Interstate Commerce Act, in prohibiting the issuance of free transportation, expressly excepts the classes to which free or reduced service has been rendered by appellee in the City of Louisville; and we submit that this criticism of the Master's report by appellant is unjust, and ought not to be sustained.

The remaining items of expense for the year 1908 to which appellant excepted amount to \$11,883.76. They are all based upon the testimony of Mr. Warren, Mr. Farnham's clerk, who not only never had any experience in the telephone business, but never before examined telephone accounts; and this witness, who was himself a defaulting bookkeeper (Trans., vol. II, pp. 1119-20), has undertaken to criticise expenses which are shown by appellee's Auditor and General Manager to have been incurred in the conduct of its business. And, in addition to this, even Mr. Warren's criticism of these items is based largely upon assumptions in the questions asked him by counsel for appellant.

But if each and every item should be allowed in accordance with appellant's contention, the result of this case would not be affected in the slightest degree.

With respect to the contention of appellant that the ordinance rates would have produced a larger net revenue than the rates charged by appellee, the contention of appellant seems to be based upon the theory that if appellee had charged the large, heavy users of telephone service a *less* price, this would have justified appellee in charging the small users a *larger* price, so that the average price charged would have been higher, and consequently yielded a larger net revenue. It is sufficient to say that no witness has undertaken to point out how this could have been done, and, indeed, it is difficult to understand how charging larger users *less* would induce smaller users to pay *more*. It seems to us that the reverse is bound to be true. Charging the larger users less would, of necessity, cause the smaller users to insist upon less; and it is inconceivable that an argument to the small user to pay *more* because the larger user was paying *less*, would prevail.

CONCLUSION.

In the preparation of this brief we have not been unmindful of our duty to enlighten the Court as to what the record contains, without burdening Your Honors with details as to facts or deductions from facts. At the same time, we could not overlook the importance of the questions involved to our client.

The taking of testimony in this cause was begun in April, 1909, and therefore, the financial operations of appellee were of necessity confined to that time, but on March 18, 1910, the following occurred in the presence of counsel for both sides and the Master:

Counsel for appellee said:

"Now, one other thing; this case has been pending now for a year. The financial statement of receipts and disbursements was only up to the first of January, 1909. If you wish to take proof and show the result of the operations in the City of Louisville or the Louisville plant for 1909, I am prepared to do it and go into it, if you wish it done, and I tender that if the Master wishes it, or the representative of the city wishes it."

The Master:

"Right now I am not able to say whether that would be important or not. When we get through with the proof, if we want it, I will take it myself. I will just order that myself."

Mr. Granbery, for appellee:

"I merely make the tender, so it cannot be said later that we did not bring these things down to date."

Trans., vol. I, p. 691.

The Court in the opinion delivered in this cause, said:

"Of course, we are left to conjecture and guess work as to what would in fact occur under the ordinance rates, and the Court at the final hearing, submitted in writing to the counsel for the respective parties a suggestion in this language:

"Does the record furnish the Court with the means of estimating the earnings and expenses of the Company for the years 1909 and 1910, and, if not, would it not be well for a disinterested expert bookkeeper, not in the spirit of controversy, but with the view to ascertaining the figures, to make an examination of the books of the company in that connection and report the facts to the Court?"

"To this, the complainant's counsel in open Court agreed, but the defendant's counsel declined to do so for the reason then stated by him that it would further delay the final decision of the case."

Trans., vol. II, p. 1641.

In addition to the fact that the rates charged by appellee for service in Louisville have been reasonable because of the keen, active and actual competition with another company since 1902; and,

In addition to the fact that the President of appellee says: "We have tried and experimented with every conceivable class and kind of rates and every theory of rating that those that were best qualified to talk on the subject have suggested we have tried, and our experience there was that every one of them proved disastrous, disappointing and a failure. In other words, we had poor results, until this last series of rates which we inaugurated some two years ago (1907). They show a betterment of conditions; the others all show worse. So that it was not a matter of theory, but it has been a matter of actual experience with us in the City of Louisville;" and

In addition to the fact that the officers of appellee's rival, the Home Telephone Company of Louisville, "have publicly stated that its rates are ruinously low, and stated that said company is unable to care for its plant and operate the same upon the rates fixed in its contract with the city:"

Answer of appellant, Trans., p. 35.

There is still another convincing reason why the rates charged by appellee should be sustained as reasonable.

The question of rates for telephone service charged by appellee in the City of Louisville was taken up by the Board of Trade of the City of Louisville, and in April, 1907, appellee agreed that the Board of Trade might appoint a committee of five citizens of Louisville who should investigate telephone conditions and fix reasonable rates for

telephone service in that city for a period of three years; and appellee further agreed that in the event the Board of Trade committee should find that the rates being charged for service were excessive or unreasonable, it would refund to every patron the difference between what appellee was charging and the rates found by the Board of Trade committee to be reasonable and fair. This committee was appointed from among the best known citizens of Louisville, and they made a report, which is as follows:

"LOUISVILLE, KY., Aug. 16, 1907.

"To the President and Directors, Louisville Board of Trade:

"Gentlemen: The undersigned, a special committee appointed by the Board of Trade and accepted by the Cumberland Telephone & Telegraph Company as a committee to investigate as to what constituted a fair and reasonable rate for the Cumberland Telephone & Telegraph Company to charge for its service in the City of Louisville, now beg to report:

"1st. After considering the subject carefully and ascertaining all the facts bearing on it which could be ascertained from trustworthy sources, notably by sixteen meetings held at Board of Trade rooms, beginning April 3, by frequent personal conferences with the officers and more expert employes of the Cumberland Telephone & Telegraph Company, and by a thorough examination of the books and accounts of said Cumberland Telephone & Telegraph Company, at the hands of an expert accountant, selected by the committee, viz.: W. J. Munster, of Cincinnati, we find that the average net yield to said Cumberland Telephone & Telegraph Company from its investment in the City of Louisville, since it acquired ownership of the Louisville property seven years ago, has been but 4.14 per cent per annum.

"2nd. That the rates for telephone service in the City of Louisville proposed to—put into effect by said Cumberland Telephone & Telegraph Company March 1, 1907—are proper and reasonable, because they will not yield to said Cumberland Telephone & Telegraph Company more than a fair and equitable return on its investment in the City of Louisville.

"3rd. The Committee further declares that the rate or rates for the various classes of telephone service in the City of Louisville put into effect by said Cumberland Tele-

phone & Telegraph Company, March 1, 1907, should be maintained as a rate for such service for the three years beginning July 1, 1907."

"This report is predicated upon the promise and agreement of the company to give the best possible service to its subscribers and to furnish them at all times with most approved devices and appliances for the transmission of messages.

"Respectfully submitted,

"MARION E. TAYLOR, *Chairman*;

"WILLIAM R. BELKNAP,

"AITHIA CON,

"GEORGE GAULBERT,

"LOGAN C. MURRAY."

Thereafter, in December, 1908, another committee made a further investigation, and they reported:

"LOUISVILLE, KY., Dec. 16, 1908.

"*President and Directors Louisville Board of Trade*.

"Gentlemen: The special committee provided for by resolution of the Board of Directors, August 26, 1908, to make investigation as to the complaint of Mr. C. M. Bullitt that the Cumberland Telephone & Telegraph Company was unfairly raising its rates for service in this city, and was discriminating in its rates amongst its patrons, etc., have to report that they have carefully made inquiry as to the facts and have failed to find a single instance in which said telephone company has charged a rate for any of the various classes of telephone service other than was determined by the old committee of the Board of Trade (which agreement was to determine the rate for a term of three years), in its report submitted to the Board of Directors of the Board of Trade, September 4, 1907, nor have we found any discrimination as between patrons, except that the increase in rates allowed by the old committee was not made by the telephone company to all patrons at the same time, for the reason, as stated by the company, that there were outstanding contracts between the company and its patrons which expired at different times, and for the further reason that it was not feasible for the company to at once so alter its rules as to make the new rates apply to all patrons at the same time.

"In regard to whether the rates determined upon by the old committee, under the agreement between the Board of Directors and the Cumberland Telephone & Telegraph Company in April, 1907, are fair and reasonable, your committee have only to say that the old committee appears to have made a most thorough investigation of the whole subject, their inquiry extending through five months, during which time they held sixteen meetings; had before them for interrogation officers and employes of the telephone company, and others, and the assistance of a high-grade expert accountant employed by the committee, and we have nothing before us on which we can base an opinion that the old committee erred in its conclusion.

"Your committee desires to call your attention to the fact that under the agreement with the Telephone Company, the rates fixed by the old committee were to stand for three years from July 1, 1907, and that about one-half of that time has now expired. If at the expiration of the full period of three years it is found that the profits of the Telephone Company, after careful and economical conducting of its business, have been greater than should be allowed, the rates and charges for the future can be intelligently adjusted.

"We ask that this report be received and filed and that the committee be discharged.

"Respectfully submitted

"MARION E. TAYLOR, *Chairman.*

"WILLIAM R. BELKNAP.

"LOGAN C. MURRAY.

"HARDY BURTON.

"CHARLES EARL CURRIE."

Contrasted with this action of two committees of well-known citizens of Louisville in making a thorough investigation of telephone conditions in that city, is the action of the City Council in arbitrarily adopting a schedule of rates without any investigation and without any knowledge whatever of what were reasonable and fair rates.

The voluminous record in this case was, in our opinion, wholly unnecessary. It is the result of suspicion and an unwillingness on the part of the city authorities to concede to the management of appellee, and its employes, any presumption of fair dealing, integrity or veracity. The answer of the city in this cause discloses that this was the attitude of the city officials towards appellee.

In taking evidence in this cause Appellant's counsel endeavored to show the Appellee's president had *stolen* \$20,000.00 of his Company's funds, when the facts disclosed that Appellee's president had loaned his personal credit to his Company, and the \$20,000.00 item was an endorsement by Appellee's president of his Company's note.

Counsel for Appellant also asked Appellee's president numerous questions intimating that he had *wilfully* and *intentionally* misrepresented material facts to the Board of Trade Committee, when the facts in the record clearly showed that there had been *no* misstatement of facts to the Board of Trade Committee by any one.

And this feeling was increased by the action of the witnesses employed by the city. The Mutual Audit Company, of which Mr. Farnham was General Manager, was employed by the city to furnish expert accountants. Mr. Farnham and four assistants spent more than two months examining the records, vouchers, payrolls, and other books and papers of appellee touching its Louisville business.

It developed later that during the progress of this investigation Mr. Farnham had in his employ a discharged local cashier of appellee who had embezzled the funds of appellee in Louisville; the accounts and expenses of appellee in conducting its Louisville business were re-arranged in accordance with the statements of this discharged employee, who was not brought to appellee's offices where its records are kept and were being examined, but was secreted in a boarding house, and from that point gave information from day to day to Mr. Farnham and his assistants. After the examination was completed Mr. Farnham dared not take the witness stand and subject himself to a cross-examination on the work done by him and his assistants on the books and records of appellee; but one of his clerks, a Mr. Warren, was placed on the witness stand to prove the result of the investigation by Mr. Farnham and his assistants, and it developed that this clerk had himself been a defaulter, and had been driven from his place of trust because of his defalcation.

In addition to this, the first telephone engineer employed by the city to give evidence as to the value of appellee's plant came to Louisville for the first time in his life, and after talking to the City Attorney and a traveling salesman for a manufacturer of telephone equipment, without the slightest examination or knowledge of appellee's plant in Louisville, gave an affidavit, stating that he could duplicate appellee's

plant in the City of Louisville for \$1,000,000.00. For these services he collected \$100.00 and his expenses and took the train back to Chicago.

It is, therefore, not surprising that the city officials should labor under erroneous impressions in regard to appellee's business in Louisville, and view with suspicion even the plainest and most obvious things in the business.

This expert accountant, Mr. Farnham, in making up a statement as to earnings for 1908, declined to allow the amount actually expended by appellee on reconstructing its plant in the year 1908, under the specious plea that all such expenses should be charged to reserve, and yet he did not create any reserve out of earnings to which this expense actually incurred during 1908 could be charged.

Under these conditions this record has been made up, when a fractional part of it contains all of the facts material to this inquiry.

As was said by the Supreme Court in *Knoxville vs. Knoxville Water Co.*, 212 U. S., 18:

"Our social system rests largely upon the sanctity of private property, and that State or community which seeks to invade it will soon discover the error in the disaster which follows. The slight gain to the consumer, which he would gain from a reduction in the rates charged by public service corporations, is as nothing compared with his share in the ruin which would be brought about by denying to private property its just reward, thus unsettling values and destroying confidence."

The importance of this case is far reaching to appellee. Its exchange in Louisville is not alone involved. Its entire system will be affected. If Louisville can, without investigation, adopt arbitrary rates, then other cities will do the same, until the integrity of appellee's property is destroyed. Each city will enter upon a contest with the others to secure lower proportionate rates, until the life of the business has been taken.

We respectfully ask an affirmance of the decree.

Respectfully submitted,

ALEXANDER POPE HUMPHREY,
ALEXANDER POPE HUMPHREY, JR.,
WILLIAM L. GRANBERY,

February, 1912.

Solicitors for Appellee.

APPENDIX.

Since the preparation of our brief we have received the brief of appellant. On'y a few suggestions in reply are deemed necessary in view of our exceptions to the Master's report and our brief.

Many matters are now criticised by appellant, although *no exceptions* on these matters were filed to the Master's report.

The only suggestions we have to offer are these:

VALUE OF PLANT.

The conflict in the evidence as to the value of the plant is not nearly so serious as is contended in appellant's brief. The conflict is more apparent than real. It may be stated that an examination of the depositions of two of appellant's expert engineers—Messrs. Crumb and Levings—is sufficient to show that they have no knowledge of the plant in Louisville, and have never had experience sufficient to justify them in valuing the plant, even though they had carefully inspected it. The only other witness introduced by appellant is Mr. Polk, who is a telephone engineer, and his difference with witnesses for appellee grows out of a difference in knowledge and experience with the Louisville plant. Only a few differences need be noted to show that the valuation of Mr. Polk is unreliable.

He values the apparatus in the Louisville plant about \$100,000.00 less than the undisputed proof shows that it cost, upon the idea that there are *other* types of apparatus which he thinks *equally* as good and which cost *less* money. That is to say, appellee's officers, exercising their judgment and spending their company's money in the purchase of apparatus, are not to be trusted; but the judgment of Mr. Polk must be accepted as to the make of apparatus which should have been purchased.

Mr. Polk *estimated* the number of poles in the plant at 11,000 (Trans., p. 1401); the actual count of the poles showed the number to be 13,870. (Trans., p. 625.)

Mr. Polk *estimated* the private branch exchanges in the plant at 75 (Trans., pp. 1408-9); the actual count showed there were 112. (Trans. p. 650.)

In one deposition Mr. Polk values the private branch exchanges and sub-station equipment at \$128,775.00, or an average of \$13.70 per station (Trans., p. 1408), and in his second deposition he states they are worth \$25.00 per station (Trans., p. 1449); thus making a clear error against appellee of more than \$106,000.00 in the valuation of this part of the plant.

Mr. Polk's valuation is a theoretical valuation of a supposed plant in the City of Louisville serving a certain number of subscribers; whereas, appellee's witnesses are valuing the actual plant in Louisville, after taking an inventory of actual quantities of each class of material in the plant.

A great deal is said about certain equipment being purchased for the main exchange and then taken away without crediting the main exchange. The facts are very simple. Appellee has four exchange offices in the Louisville plant. Certain equipment was purchased for the main exchange, but before it was erected it was taken from the "Main" exchange building and erected in the "West" exchange. This equipment was a part of the Louisville exchange, whether erected in the "Main" or "West" exchange building.

Jagoe's dep., Trans., p. 648.

Crumb's dep., Trans., p. 879.

TOLL EQUIPMENT.

Appellant insists that a large part of the toll equipment in the Louisville Exchange should not be considered a part of the Louisville Exchange in fixing rates for exchange service. There is no confusion in the record on this point.

In order that each subscriber may, from his individual station, have access to and use the toll lines, it is necessary for appellee to install equipment which will enable this to be done. This equipment is installed solely and alone for the convenience and benefit of the subscribers to the Louisville Exchange, and it is considered a part of the Louisville Exchange; it is necessary only to enable the

local subscribers to have access to the toll lines from their individual stations. It is taken into consideration in fixing the exchange rates (Trans., p. 677). There is no dispute whatever about this in the record, and the only place it is contested is in appellant's brief. A mere statement of the facts, we submit, is a sufficient answer to the contention of appellant on this point. This equipment would not be there *except* to accommodate the Louisville Exchange subscribers.

SURPLUS OF FACILITIES.

Criticism is *now* made by appellant to the surplus of facilities in the plant, *although* the Master reported that this was proper, *and there was no exception filed by appellant.*

A surplus of facilities is necessary in a telephone plant.
The Master reported:

"These figures include a large amount of what the witnesses denominate 'surplus equipment.' This surplus is found in the aerial system, in the conduit system, and in the exchange switchboards.

"The evidence shows, and I so find, that it is not prudent or wise for a telephone plant like the one in Louisville, to be constructed merely to meet the immediate demands of the public; that such a plant should be built with an eye to the future, and that there should be a surplus equipment in every department sufficient to meet the demands of a period of several years, so that the wants of the new subscribers may be supplied on short notice. The evidence shows that there are more poles in the county outside of Louisville connected with the exchange or intended for the Louisville Exchange, than the present business of complainant demands; but, as stated above, I am unwilling to condemn or to eliminate from the Company's plant this surplus equipment."

Supplement to brief, p. 44.

Appellant, in its answer, "admits that it is impossible to conduct the telephone business in a city the size of Louisville without making provisions for the future growth of the business . . . admits that it is proper and prudent that appellee should provide in advance for anticipated patronage."

Trans. p. 36.

A surplus of facilities is necessary for two reasons. The President of appellee says:

"Q. I will ask you to state whether or not it is necessary or proper that future business be anticipated and facilities provided prior to the offering of the new business?

"A. Yes, for the reason that it requires quite a length of time to provide additional facilities on an exchange and the customers could not be expected to wait so long a time for the service; hence, it is not only necessary but it is practiced in all companies which expect to meet the public requirements, to keep a certain surplus reserve of facilities always on hand, and as they are used up, to provide others, so that they will be able to meet the demands promptly, and any other method would leave the service open to very grave criticism and reflection, for the old customers have an interest in having new ones connected, have an interest quite as important as the new customer, for every new customer gives an additional value and opportunity to all the old subscribers.

"Q. What would be the result, practically, if the company should not provide facilities for future growth before such new business was offered, but should wait until the new business was offered before undertaking to provide facilities necessary to serve the new patrons?

"A. Well, as it would often require a year in which to provide additional facilities, it is quite plain what a disappointment it would be and how far short a company would fail of meeting the public requirements, for the customers usually desire the service at once, and certainly could not be expected to wait longer than a very few days. They rather expect to have the facilities supplied to them within twenty-four or thirty-six hours, and they have been accustomed to that so long, that it is now recognized as a fixed condition. If, therefore, conditions should arise that would make delay in providing service longer than this, the company would be considered as wholly inadequate, and indeed, open to the criticism of being a rather poor affair."

Dep. of Caldwell, Trans., pp. 506-7.

In the second place, after poles, wires and cables are run to each subscriber's place of business or residence, it often happens that the telephone company loses subscribers in one locality and gains subscribers in another locality in the city. Two things then happen, the company must erect *new* poles, wires and cables to reach the *new* subscribers, and the *old* poles, wires and cables which have served *old* subscribers, must remain idle until new subscribers are found to use these old facilities. In this way, after a plant has been in operation

any length of time, there is of necessity in the plant, facilities which are, for the time being, idle. This is all clear in the record, and as stated, appellant made no exception to the Master so reporting.

In addition to this, it appears in the record that while appellee had a surplus of cable in *some* parts of the city, it was at the time this record was being made, preparing to erect new cable in other parts of the city.

Appellee's President says:

"Q. Mr. Polk has stated that the company had excess cable facilities in the Louisville plant, sufficient to accommodate 8,000 additional subscribers. Do you know whether that is true or not?

"A. I don't know that fact. It is new to me, and I don't think it is true. We carry and aim to carry a certain excess service to take care of customers, as they come in the ordinary growth, and I do know that we have some surplus here. It might be that we would have that amount of surplus in some conduit space. We might have it in buildings. We might have adequate space in our buildings, and as I say, in the conduits, but to say that we have that as a complete equipment, ready to take on those customers, that would not be true.

"Q. Is the company contemplating at the present time any extension of the cable system in the City of Louisville?

"A. Yes, sir; we have under consideration, right at once, an extension which is estimated to be something like \$20,000, that is to take on customers in a part of the city where the facilities are already exhausted and the growth is increasing."

Dep. of Caldwell, Trans., pp. 836-7.

It must be apparent that these conditions are inherent in the business. If these surplus facilities are not to be treated as properly a part of the plant, then the expenses must be increased to pay for facilities erected for customers, and then taken down whenever they happen to become idle on account of the shifting of patrons from one locality to another in the exchange area.

It must, also, be apparent that in constructing buildings and an underground system, the future must be provided for. Additions to buildings cannot be made as new subscribers are obtained, and the streets cannot be torn up to lay conduits as needed. These things must be anticipated when the original construction is undertaken.

RECEIPTS AND DISBURSEMENTS.

It would serve no useful purpose to undertake a reply to appellant's argument on this question. It is sufficient to say that appellant has, in discussing this matter, abandoned its answer, its expert accountants and engineers, the Master's report and the opinion of the trial Judge. Appellant has constructed a theory of its own assuming facts which are refuted by every witness in the record. That theory is that increased patronage will not increase expenses, although the answer admits that it does; that charging the large users *less* will enable appellee to charge small users *more*; that the rate ordinance compels every patron to pay the ordinance rates, and that no other rates for other classes of service can be offered by appellee. Under these assumptions, certain results are claimed by appellant. Since no witness undertakes to sustain these assumptions, and *all* the witnesses refute them, it can serve no useful purpose to undertake to reply to the argument of appellant.

The Auditor of appellee stated the receipts and disbursements. The accountants stated them substantially as the Auditor. The Master reported them as found by the accountants, and the trial Judge practically sustained the Master. Under these conditions, what we have said in our own brief and in our exceptions to the Master's report is deemed a sufficient reply to appellant's argument.

DEPRECIATION.

There were no exceptions filed by appellant to the report of the Master in stating that seven per cent per annum upon the value of the plant, exclusive of supplies and real estate, was the proper amount to set aside for depreciation; yet, much is said in appellant's brief against the allowance of this, or any other amount, for depreciation. The contention by appellant is the result of a misunderstanding of depreciation. The entire argument on this point is based upon the erroneous assumption that a telephone plant is a completed property as soon as it is built and ready to give service, and that depreciation sets up evenly in all parts of the plant and continues throughout the life of the plant. Indeed, the illustration used in appellant's brief

shows the error of the argument. Depreciation in a telephone plant is likened to an engine in a waterworks plant, which is one single piece of machinery and is operated for twenty years and then renewed in *toto* . The telephone plant, on the contrary, is never a completed property, and the life of the component parts of the plant varies. Some parts of the plant are renewed annually. Other parts are not renewed for years.

In addition to this, a telephone plant begins with a certain number of subscribers and as new subscribers are added the plant is enlarged and added to so that the new customers may be served in connection with the old customers. In this way the telephone plant continues to grow larger, and, therefore, at no given time is it a completed plant.

Various parts of the plant have different periods of life, and the same kind of material in the plant is added at different times. That is to say, poles, wires and cables erected to serve new subscribers are added to the plant later than poles, wires and cables that were put in at the time the plant was first erected. Depreciation is being cared for on some parts of the plant yearly; and, therefore, the problem of depreciation in a telephone plant is by no means a simple one.

If depreciation could be cared for year by year there would be no necessity for an inquiry into what is a proper amount to allow for depreciation. All that would be necessary would be to ascertain what had been spent year by year on depreciation.

Appellant's counsel undertakes to draw conclusions from the experience of appellee over a period of 25 years in caring for depreciation of its plants. But the fallacy of the argument is seen when it is stated that the 517 exchanges owned by appellee were not built in 1883 and operated continuously to the present time, but they have been built from time to time. Some are new; some are old. Parts of some are new; and parts of some are old. The construction of these plants has been gradual, and therefore, the conclusion sought to be drawn by appellant's counsel from appellee's experience in caring for depreciation is wholly inapplicable. The Louisville plant is a good illustration. When appellee bought this plant in 1900 it was serving only about 3,000 subscribers. It is to-day serving

about 10,000 subscribers. In other words, the plant has been enlarged from year to year as new subscribers were added, so that in this way more than \$1,000,000 has been added, year by year, in additions to the plant from 1900 to 1908. Therefore, it will not do to say that the same amount was required for depreciation in 1900 as is required in 1908. In other words in 1900 there was a plant worth less than \$700,000 on which depreciation was accruing, and in 1908 there was a plant worth \$1,700,000 upon which depreciation was accruing.

Therefore, it is submitted that the argument of appellant's counsel is based upon an erroneous assumption of facts. This question of depreciation is, we submit, sufficiently considered in our brief, page 36, and in our supplement to the brief, page 110.

It is worthy of note, however, that each and every witness in the record (both for appellee and appellant), the Master and the trial judge, all disagree with appellant's theory, which is only a theory.

REDUCTION IN EARNINGS UNDER ORDINANCE RATES.

Counsel for appellant insists that the Master was in error in finding that if the ordinance rates had been in effect during 1908 the receipts of appellee would have been reduced \$49,721.76.

It is submitted that, in view of the agreement entered into between counsel representing appellant and appellee in the presence of the Master, and approved by him, this item of what would have been the reduction under the ordinance rates should not be contested in this Court.

It appears in the record that by agreement each side selected an expert accountant to examine the books and records of appellee and to make a report to the Master upon all points upon which they could agree; and it was stated by the Master in the presence of counsel for both sides that whatever these expert accountants agreed upon and jointly reported would be accepted by him as final, and no proof should be permitted to vary or contradict such joint findings of fact, and to this both sides agreed.

Supplement to brief, pp. 189-190.

On June 7, 1909, during the investigation of the books by the accountants, at a conference at which were present counsel representing both litigants and representatives of both accountants, the Master stated:

"Here are two auditors, by agreement of parties, allowed access to the books of the complainant Company; and it is agreed that these auditors, after a thorough examination of all the papers connected with the case, shall make a joint report, so far as they may be able to agree, upon any and every proposition. The report, so far as it is the joint report of the two auditors, must be accepted by both litigants, by the Special Master and by the Court, as true; and I take it that no proof ought to be allowed from any extraneous source as to the correctness of that joint report."

Supplement to brief, p. 190.

And when the evidence was nearly completed, at another conference with the Master, at which counsel for both sides were present, he stated:

"It was my distinct understanding when that agreement was made that whatever the two experts reported jointly, should be accepted as a finality by the Commissioner."

Supplement to brief, p. 191.

The joint accountants reported that the reduction that would have been brought about in the receipts of appellee for 1908 if the ordinance rates had been in effect, was \$49,721.76, and the Master accepted this joint report and so reported to the Court.

But what is said by counsel for appellant shows that the joint finding of the accountants is fully sustained.

The only witness who speaks upon the subject is Mr. Warren, introduced by appellant, and he says the method of ascertaining what would have been the reduction, was:

"By taking each telephone subscriber as it was listed on said exhibit (Smith's Exhibit No. 6), and taking the revenue that would be derived from the rental rate as indicated by the exhibit, and also taking the rental that would be derived if the rental charged were at the rate as fixed by the ordinance for the same classification of telephones, except in cases where the rate

for services were less than the regular rates for such service, in which case the revenue remained in both places and in both statements the same as that charged by the Cumberland Telephone Company."

Trans., p. 1110.

This, we submit, is an accurate and the proper way to ascertain what would have been the reduction; it could not have been ascertained in any other way.

The real insistence of appellant in its brief is, that because of discrimination in the rates, and because appellee was charging some patrons less than was prescribed in the rate ordinance, the accountants in determining the reduction should have assumed that each and every patron in Louisville would be charged the rates prescribed in the ordinance, whereas many classes of service were not affected by the rate ordinance, and therefore, these prices could not be increased. Indeed, appellant seems to think that because the City has prescribed maximum rates for certain classes of service, each and every patron must pay these particular rates, and that no other rates for any other class of service can be established.

There is nothing in the rate ordinance requiring patrons to pay as much as the rates prescribed in the ordinance, nor is there anything in the rate ordinance undertaking to fix a price for all kinds of service furnished by appellee to its patrons in the Louisville exchange.

In addition to this it must be borne in mind that appellee was not in the situation where it could *force* patrons to pay any price it demanded, because it was operating its plant in Louisville under keen, active and actual competition, and therefore, what it did had to be done in view of this competition.

While it is stated that there was discrimination between patrons to the Louisville exchange, yet the record does not sustain this contention. The record does show that many patrons are paying different prices, but the record does not show that it is the same class of service that is received by patrons paying different rates.

The question of discrimination was carefully investigated in December, 1908, by a committee of the Louisville Board of Trade, and this committee reported that there was no discrimination.

Trans., p. 61.

The fixing of a schedule of telephone rates for a large city like Louisville is a very complex and technical matter, as was said by the Chicago Commission:

"A telephone company in a large city must face a problem in many respects more complex than that of any other public utility corporation. The water department is called upon to sell a single commodity, namely, water, and at prices which are fixed with comparative readiness. The gas company also is called upon to sell a single commodity, metered for nearly every customer, and its conditions in dealing with customers are relatively simple. It may sell some additional by-products, as coke, tar and ammonia, but the quantities and market values of these are readily arrived at. The traction company has a more complex problem than some of the other purveyors of public utilities, but even here the price paid by the several patrons is uniform and the substantial difference between patrons lies only in the lengths of the rides which they may choose to take.

"The telephone problem, on the contrary, involves many complexities, partially caused by the relatively large number of classes of service which the telephone company must offer its patrons for the purpose of fully developing the telephone service of the city, and partially by the intangible character of the electric medium with which the telephone business is carried on, the delicacy of the apparatus used, and the wide difference in the manner and extent of the use of the apparatus by the various subscribers.

"If a telephone company properly extends the telephone service in the city, it must be prepared to take care of the requirements of a range of patrons as wide as the interests of the city itself, including the largest business organizations, the hotels, the newspapers, the professional men, the small business houses, and residences of all classes. It must provide apparatus for the service of each class of patrons which will enable it to furnish the service to each subscriber at an appropriate price within his means. It is desirable for the prices to be graded so that the largest user shall not pay less than his fair share of the expense of maintaining the traffic and the remuneration to the company for its investment, and equally so that the smallest user may get his telephone service at a price which is within his means and yet is reasonably remunerative to the company for its outlay."

Trans., p. 824.

CONCEALING FACTS.

It is stated in appellant's brief that appellee should be repelled from this Court because it has sought to conceal facts with respect to its business in the City of Louisville.

The record discloses that instead of there being any concealment, or effort to conceal the facts, there was the greatest latitude accorded to appellant in preparing this case. Appellee permitted four experts employed by appellant to spend more than two months in examining its records, and one of the witnesses states that there was no difficulty on the part of the experts in getting access to all the books, records, vouchers and papers of appellee during this investigation, and every facility was afforded the accountants to make the examination. (Trans., p. 706.) Blue prints, as near complete as appellee had, were furnished to the expert engineers employed by appellant so as to facilitate work in estimating the value of the Louisville plant. Employees of appellee not only carried these experts into the different buildings so that they might inspect the apparatus used in the Louisville plant, but furnished vehicles and went with one of these experts to such parts of the city as he indicated.

Appellant bases a criticism on this: During the cross-examination of appellee's auditor counsel for appellant asked the witness to produce records from a different department with which the witness had nothing whatever to do. The name of the employe having charge of these records was furnished to appellant's counsel, but appellee's counsel declined to make the witness furnish records he himself knew nothing about and which were not under his control or in his department. The following questions and answers are pertinent:

Counsel for appellant:

"Can you produce anybody connected with the supply department, and will you produce a witness who will testify that the poles represented on that paper I have read you, were used in constructing the Louisville Exchange?"

Counsel for appellee:

"I object to the question, because the witness is not supposed to be furnishing other witnesses. He is here to testify as to what he knows, and not to produce witnesses for examination."

Trans., p. 280.

There was no application to the Master to compel this witness to furnish other witnesses.

A great deal of criticism is made as to the lack of knowledge of appellee's auditor on cross-examination, but it is submitted that a perusal of this cross-examination will show that it would have been utterly impossible for any one to have known about as many different things and as much about all things as it was sought to obtain from this one witness; and it is submitted that this witness' deposition shows that he was frank, and gave to appellant's counsel all the information that it was possible for him to give.

Appellee did object to accountants selected by appellant examining its records and making a secret report to appellant, but it volunteered to allow the Master to select an accountant who would report to the Master, and when this was declined by appellant, volunteered to allow a joint examination by accountants to be selected by each side. This, we submit, was fair and ought not to subject appellee to criticism.

Supra, p. 26.

The fact that appellee has been paying dividends upon its stock seems to have been puzzling to the Master and is commented upon in appellant's brief. The entire business of appellee is not under consideration. Only one of its 517 exchanges is involved in this suit. Its system of toll lines linking its exchanges together is not involved. Whether appellee is prosperous or not is not material. Whether its toll business is its best property is not pertinent.

However, as we said in our exceptions to the Master's report:

"From the Annual Report of Complainant for the year ending December 31, 1908, which is in evidence in this case, it will be seen that complainant has outstanding only \$19,680,150.00 of stock upon which it pays dividends, and that it has invested in plant.....

\$24,381,297.64

"That it has invested in real estate and buildings.....	790,163.23
Material on hand.....	640,861.40
Stocks and bonds.....	435,599.04
Cash.....	457,546.49

Or a total of..... \$26,705,467.80

"It appears in the record that Complainant has a comprehensive system of toll-lines uniting its 517 exchanges, and from all these sources it derives a sufficient amount to pay a dividend upon stock of only.....

19,680,150.00

And five per cent bonds of only.....

1,000,000.00."

Supplement to brief, p. 187.

Finally, appellant asserts that if the ordinance rates had been in effect, appellee's gross receipts and its net profits would have been greater than they were under the rates that were in effect. If this be true, it is difficult to understand why the City ever adopted the rate ordinance. If the rates being charged will yield *less* gross earnings and *less* net profits than the ordinance rates, then the Louisville patrons, *as a whole*, would be required to pay *more* under the ordinance rates. This position of appellant is the more remarkable when it is remembered that the *heavy* reduction in the rates prescribed in the ordinance is in the rates charged the *larger* users, and the *slight* reduction is on the classes of service furnished the *smaller* users. It is not possible to assume that the city officials intended any increase in profits to follow the adoption of the rate ordinance.

Appellant, in its answer, "admits that the value of the service increases as the number of subscribers increases; admits that as the service increases, the expense of conducting the business increases,"

Trans., p. 38.

The ordinance rates would reduce the gross earnings, would *not* reduce expenses, and *would* reduce net earnings to practically *no* return upon the value of the plant. The city officials *intended to reduce the earnings of appellee*, and this is what would happen if the ordinance rates should be put into effect.

Respectfully submitted,

ALEXANDER POPE HUMPHREY,

ALEXANDER POPE HUMPHREY, JR.,

WILLIAM L. GRANBERY,

Solicitors for Appellee.

Office Supreme Court, U. S.
FILED.

MAR 4 1912

JAMES H. McKENNEY,
CLERK.

No. 761.

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D., 1911.

CITY OF LOUISVILLE, - - - - - APPELLANT,

VS.

**CUMBERLAND TELEPHONE AND
TELEGRAPH COMPANY, - - - - - APPELLEE.**

**Appeal from the Circuit Court of the United States
for the Western District of Kentucky.**

INDEX TO RECORD.

**PREPARED BY
COUNSEL FOR APPELLANT.**



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Appellee

Appeal from the Circuit Court of the United States for
the Western District of Kentucky.

INDEX TO RECORD.

NOTE—In connection with writing the brief for appellant I found it necessary to prepare an index to the record. I have caused that index to be printed and take the liberty of submitting it herewith, trusting it may save the Court some labor when it comes to consider the record.

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COST OF OHIO VALLEY PLANT.

\$255,000.00 plus the earnings of the plant in excess of dividends, represented the entire cost of the Louisville plant together with eight other plants and all toll lines, up to the date of consolidation.

Gifford, pp. 956 to 958.

Plant account of The Ohio Valley Company at the date of the consolidation showed that its nine exchanges had cost \$512,789.94.

Master, p. 66; Smith, p. 273, 277; Wilkinson, p. 721; Warren, p. 1031; Gifford, pp. 959-963.

Appellee did not purchase Ohio Valley plant. The two companies were consolidated.

Bill and Exhibits, Case 197, pp. 2, 58; Smith, p. 246; Wilkinson, pp. 727, 752, 756; Farnham, p. 1306.

The old Cumberland Telephone Company which consolidated with The Ohio Valley Telephone Company had no power to purchase stock in that company, and did not purchase any such stock.

Exhibits filed with Bill in No. 197, p. 36; Smith, p. 246.

Appellee contended that 80 per cent of the cost of the nine exchanges represented the cost of the Louisville exchange. (80 per cent of \$512,789.00 is \$410,000.00, which represents value of Louisville plant at date of consolidation.)

Master, p. 61; Smith, pp. 273, 277; Warren, p. 1035; Wilkinson, pp. 726, 727. (See also Brief for Appellee p.21.)

Appellee, however, placed on its books as the value of the Louisville plant alone the sum of \$845,000.00.

Smith, p. 452; Webb, pp. 1573, 1580.

Between 1907 and 1909 appellee changed the above figures (\$845,000.00) and placed on its books \$678,000.00 as representing the value of the Louisville plant.

Master, p. 61; Smith, p. 218, 245.

COST OF CONSTRUCTION SINCE 1900.

(See Appellant's Brief, pp. 67 to 82.)

Master's discussion of cost	62 to 66
Court's discussion of cost	1622 to 1624, 1625
Auditor's evidence concerning cost—	
A—Subscribers' equipment ..	218, 220, 349, 362, 476, 651, 1001
B—Supply department ..	282 to 285, 293 to 297, 327, 348, 362, 363, 1001, 1038, 1042, 1043
C—Payrolls	302 to 317, 1040
D—Toll construction	328, 330, 331, 336, 443

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G—Board of Trade accountant could not verify construction account	452
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(See Appellant's Brief, pp. 89 to 130.)

Master's discussion of value of plant	68, 70
Court's discussion of value of plant	1625, 1630
Massachusetts report showing value to be \$864,- 000.00	893, 660
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W. H. Crumb's reproduction value of \$975,- 000.00	876 to 887
W. H. Crumb's deposition on value	871
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S. H. Leving's deposition on value	1520
W. C. Polk's reproduction value of \$1,195,737.00	1411
W. C. Polk's deposition on value	1388, 1492
J. E. Jagoe's reproduction value of \$1,793,540.00	635
J. E. Jagoe's deposition on value	621
(See Brief, p. 33.)	
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Supplies on hand should not be allowed (see Brief, p. 128)	64

NOTE—Counsel for appellee again insists that the witness Jagoe appraised the property. This contention was exploded in the lower Court.

(See Jagoe's deposition, record, pp. 640, 641, 648, 653, 663.)

REAL ESTATE NOT INCLUDED IN VALUE OF PLANT.

(See Appellant's Brief, pp. 34, 38, 46, 155.)

Smith's deposition	214, 222, 459, 472
Warren's deposition	1082, 1086, 1100
Wilkinson's deposition	763
Burton—Value of real estate	970, 972
Brand—Value of real estate	978, 980
Treasurer—Value of real estate	1575, 1576

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(See Appellant's Brief, pp. 130 to 154.)

Court's finding on subject of earnings	1630, 1639
Master's finding on subject of earnings	72, 78, 94
Joint report of accountants on earnings	744
Auditor on earnings for 1905-8	210
Wilkinson on earnings for 1905-8	728
Warren—exchange earnings for 1908	1056
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(See also Brief, pp. 131 to 147).

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President on subject	836, 837
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(See Appellant's Brief, pp. 38 to 45, 147 to 154.)

Master on subject	100 to 103
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(See Brief, pp. 35 to 38, 133 to 146.)

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Court's report on toll department	1631
Board of Trade report on toll department	452, 453

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(See Appellant's Brief, pp. 165 to 186).

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(See Appellant's Brief, pp. 194 to 197.)

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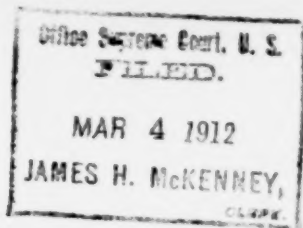
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(See Appellant's Brief, pp. 82 to 89.)

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5



Supplement to Transcript of Record.

No. 761.

Supreme Court of the United States
OCTOBER TERM, 1911.

CITY OF LOUISVILLE, Appellant

vs.

CUMBERLAND TELEPHONE & TELE-
GRAPH COMPANY, Appellee

JOINT REPORT OF ACCOUNTANTS.



Supreme Court of the United States

CUMBERLAND TELEPHONE & TELEGRAPH
COMPANY

vs.

CITY OF LOUISVILLE, KENTUCKY

*To the Honorable Henry Burnett,
Special Master,
Louisville, Ky.*

DEAR SIR:

Acting in accordance with your instructions to us, given in conformity with order dated April 2, 1909, by United States Circuit Court for the Western District of Kentucky, at Louisville (Honorable Walter Evans, Judge), we, the undersigned, Accountants for the Complainant and for the Defendant, respectively, have made an examination of the books of account and records of the

CUMBERLAND TELEPHONE AND TELEGRAPH COMPANY

kept at the principal offices of that company, at Nashville, Tennessee, for the purpose of determining the cost to the Complainant of its plant and property in the City of Louisville, Kentucky, to date of March 6, 1909, and the Income derived from the operation of said property for the years 1905, 1906, 1907 and 1908.

THE EXAMINATION

Said examination was begun on May 4, 1909, and has been in progress ever since that date. We now beg to report as follows:

Said examination involved a close inquiry into all matters relating to the business of the Complainant in the City of Louisville, including the books of account, vouchers, pay-rolls, agents' reports, and other original sources of information, kept at the principal office of the Complainant in the City of Nashville, Tennessee.

Answering each of the several paragraphs of the Order of Court, dated April 2, 1909, by a separate section, we beg to report as follows:

Section 1.—The Accountants have drawn off an abstract from a subsidiary book of account, kept for the purpose, which shows the cost to the Complainant of its telephone plant in Louisville, as of record and as indicated by the Vouchers and Pay-rolls. The total cost thus recorded, up to March 6, 1909, is the sum of \$1,700,536.91; to this has been added the sum of \$4,707.16 (Voucher No. 2588, April 17, 1902, for switchboard equipment, which should have been charged to Louisville, but was improperly charged to Nashville). From these amounts we have deducted a total of \$2,852.39, in respect of certain items improperly distributed against "Construction Account—Louisville."

Synopsis of the Above

Shown by the books	\$1,700,536.91
Add Equipment	4,707.16
	<hr/>
	\$1,705,244.07
Deduct Sundry Items	2,852.39
	<hr/>
Corrected Total	\$1,702,391.68

Expended on Construction, 1900 to 1908

The Accountants agree that the books of account of the Complainant show that the amount expended on Construction from 1900 to 1904, was the sum of \$ 857,310.39
 and the amount similarly expended from 1905 to 1908, was the sum of 166,234.95
 Making a Grand Total for the Nine Years, of .. \$1,023,545.34

Stated by years, the amount so expended, was as follows:

Expended in 1900.....	\$166,775.23
Expended in 1901.....	178,549.14
Expended in 1902.....	217,128.05
Expended in 1903.....	163,486.84
Expended in 1904.....	131,371.13
<i>Total 1900 to 1904.....</i>	<i>\$ 857,310.39</i>
Expended in 1905.....	\$ 60,691.21
Expended in 1906.....	80,125.15
Expended in 1907.....	20,770.42
Taken out during 1908 (net).....	4,351.83
<i>Total 1905 to 1908.....</i>	<i>166,234.95</i>
TOTAL.....	\$1,023,545.34

Section 2.—We have discussed the method to be followed in arriving at an estimate of the present value of the telephone plant of the Complainant in the City of Louisville, and we find that we can not agree as to said method.

Section 3.—We agree that the Gross Earnings of the Complainant, during the four years 1905, 1906, 1907 and 1908, as shown by the books of the Complainant, and as classified therein, and placed to the credit of Louisville Exchange, including 15% of the Toll Earnings, were as follows:

1905.....	\$ 269,823.38
1906.....	294,498.44
1907.....	319,758.51
1908.....	325,838.30

The Gross Earnings are classified as follows:

	1905	1906	1907	1908
1. Exchange Service.....	\$264,675.13	\$280,076.12	\$297,501.14	\$307,431.85
2. Proportion of Toll Earnings ..	6,539.92	7,064.91	8,030.15	7,632.11
3. From Telegraph Companies.....	983.88	1,018.12	939.48	761.79
4. From American Telephone & Telegraph Company.....	2,865.29	3,427.09	3,864.17	3,272.37
5. Private Line Rentals.....	1,342.01	1,079.92	1,153.91	*
6. Poll Service and Attachments	953.11	1,096.28	1,177.75	1,229.99
7. List Advertisements	751.83	2,497.25	2,984.22	3,151.59
8. Telegraph Drops	215.49	976.40	2,110.61	2,130.55
9. Messenger Fees.....	862.02	812.40	769.15	658.30
10. Removals and Miscellaneous.....	1,001.12	680.53	3,278.70	2,682.97
<i>Gross Total</i>	<i>\$280,189.80</i>	<i>\$298,729.02</i>	<i>\$321,809.28</i>	<i>\$328,951.52</i>
<i>Deduct Bad Debts</i>	<i>10,366.42</i>	<i>4,230.58</i>	<i>2,050.77</i>	<i>3,113.22</i>

Total Gross Earnings
of the complain-
ant as placed to
the credit of Louis-
ville Exchange:

<i>Year 1905</i>	<i>\$269,823.38</i>
<i>Year 1906</i>	<i>\$294,498.44</i>
<i>Year 1907</i>	<i>\$319,758.51</i>
<i>Year 1908</i>	<i>\$325,838.30</i>

*In 1908 "Private Line Rentals" were reported from the Exchange and included in \$307,431.85 "Exchange Service."

Operating Expenses of the Complainant in Conducting Its Business in the City of Louisville During 1905, 1906, 1907 and 1908.

	1905	1906	1907	1908
1. General Ex -				
penses (prorated)	\$ 11,205.34	\$ 11,270.15	\$ 11,226.76	\$ 9,531.29
2. General Ex -				
pense (direct)	29,271.49	35,948.37	34,826.91	32,545.46
	\$ 40,476.83	\$ 47,218.52	\$ 46,053.67	\$ 42,076.75
3. Operating E x -				
penses	84,264.54	80,738.06	79,661.04	75,440.28
4. Maintenance	49,819.14	52,796.93	65,616.31	54,705.91
5. Reconstruction	41,051.02	40,626.07	41,895.10	31,450.07
6. Instrument				
Expense	11,559.76	12,518.70	13,372.49	13,722.52
Total Operating Ex -				
penses.				
Year 1905	\$227,171.29			
Year 1906		\$233,898.28		
Year 1907			\$246,598.61	
Year 1908				\$217,395.53

Section 4.—Probable Result for 1910.

We have made a calculation showing the amount in which the Complainant's Gross Earnings will probably be cut down by the enforcement of the rates fixed by the ordinance adopted by the Legislative body of the City of Louisville and approved by the Mayor March 6, 1909. We have used as the basis for this calculation a typewritten list of the names of the subscribers to the Louisville Exchange on April 1, 1909, copied from the records of the company kept at Louisville Exchange, the correct amount chargeable to subscribers for the month of April (face of contracts) is the sum of \$27,270.31.

To this list we have applied the maximum rates fixed by the ordinance and we find that the total gross earnings on this same list of subscribers for the same month of April, 1909, at the ordinance rate, would be only \$20,486.92, net.

The terms of all telephone rental contracts provide for an allowance in the form of cash discount of fifty cents a month on all rentals that are paid three months in advance.

The actual cash discounts allowed to the Louisville subscribers during the three months, March, April and May, 1909, in respect of quarterly payments made in advance, came to \$7,919.74. One-third of this sum, \$2,639.91, would be a fair deduction to make from the Gross Earnings for the one month of April (face of contracts).

This would leave the sum of \$24,630.40 to represent the measure of the Earnings actually collectible for April, 1909, under the contracts in force on April 1, 1909.

Thus we have this calculation:

Gross Earnings for April, 1909

At Contract Rates (after deducting Discounts)	\$	24,630.40
At Rates fixed by Ordinance (which are net)		20,486.92
		<hr/>
<i>Loss of Gross Earnings</i> for one month	\$	4,143.48

This is equal to a loss of \$49,721.76 a year.

Against this probable loss of \$49,721.76 a year, there will probably be an increase in gross earnings in respect of the natural growth of the business and the increased number of subscribers due to the lowering of the rates upon the enforcement of the ordinance. What this increase will amount to we can not definitely determine.

The foregoing joint report shows the money charged as the cost of the plant at Louisville; the Gross Amount credited to the Louisville Exchange as Earnings, and the Operating Expenses charged as appertaining thereto; as recorded on the books of the Cumberland Telephone and Telegraph Company. It is not an agreement that the said accounts are properly distributed or charged as we believe they should be; therefore, the right is reserved by each of the undersigned to make such individual report and the statements relative thereto, as each may feel justified in doing.

Section 5.—Charge for Depreciation.

Having discussed the matter of Depreciation, we find we cannot agree in regard thereto.

Section 6 to Section 11.—We agree that the remaining paragraphs, from No. 6 to No. 11, inclusive, of the Order of Court dated April 2, 1909, do not call for any report from us.

Respectfully submitted,

On behalf of the Complainant,

WILKINSON, RECKITT, WILLIAMS & CO.

Certified Public Accountants.

Witness,

A. D. HAMMOND.

On behalf of the Defendant,

E. W. FARNHAM.

Witness,

H. B. WARREN.

Dated at Nashville, Tenn., 7th July, 1909.

Marked Filed Nov. 17th, 1910.

A. G. RONALD, *Clerk.*

Office Supreme Court, U. S.
FILED.

OCT 9 1911

JAMES H. McKENNEY,

Supreme Court of the United States.

No. 761.

OCTOBER TERM, 1911.

CITY OF LOUISVILLE, KENTUCKY,

APPELLANT,

VS.

CUMBERLAND TELEPHONE & TELEGRAPH
COMPANY,

APPELLEE.

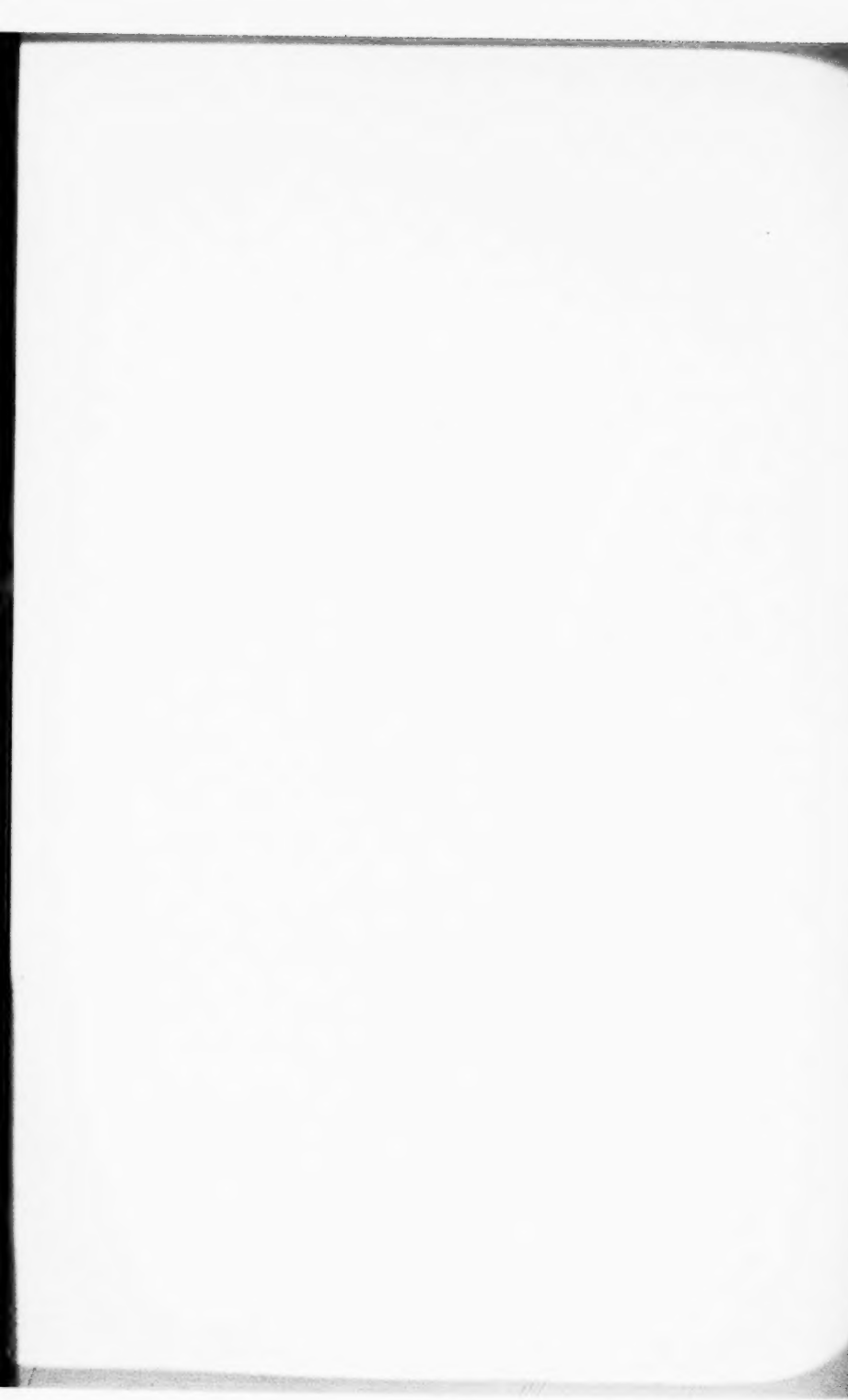
Appeal from the Circuit Court of the United States for the
Western District of Kentucky.

MOTION TO ADVANCE.

CLAYTON B. BLAKEY,

Counsel for Appellant,
City of Louisville.

HUSTON QUIN,
Of Counsel.



Supreme Court of the United States

OCTOBER TERM, 1911.

No. 761.

CITY OF LOUISVILLE, KENTUCKY,

Appellant

vs.

CUMBERLAND TELEPHONE & TELEGRAPH COMPANY,

Appellee

MOTION TO ADVANCE.

Comes now the Appellant, City of Louisville, by its City Attorney, and moves the Court for an order advancing the above entitled cause and consolidating same with the case of City of Louisville, Appellant, vs. Cumberland Telephone & Telegraph Company, Appellee, No. 197, on the docket for the October Term, 1911, of this Court, and ordering said two causes heard together; and shows to the Court the following reasons in support of its motion and application.

First: The Appellant and the Appellee are the same in both causes and the counsel for said parties are the same in both causes.

Second: The subject matter of the litigation in both causes is the same to the extent that both suits were filed to enjoin ordinances of the City of Louisville, which ordinances were enacted in an attempt by the General Council of the City of Louisville to bring about a reduction of the rates which the

Appellee was charging its subscribers in the City of Louisville and to prevent Appellee from discriminating among its subscribers. (See printed Record, case No. 197, pp. 95, 172, 173.)

One of the ordinances in question (namely, the one involved in the above styled appeal No. 761) established minimum rates which the Appellee might charge its subscribers in the City of Louisville. The enforcement of this ordinance was enjoined on the ground that the rates were so low that the enforcement of same would result in the confiscation of Appellee's property.

In the other ordinance (namely, the one referred to ~~above~~ as No. 197, October Term of this Court) the General Council repealed the franchise of the Appellee to operate a telephone exchange in the City of Louisville. This ordinance was passed after Appellee had refused to lower its rates, and the object of the ordinance was to force the Appellee to purchase a franchise from the City of Louisville, under which franchise the City could compel Appellee to charge rates lower than it was then charging, and also could force it to refrain from discriminating among its subscribers. This ordinance was declared void by the lower Court and its enforcement enjoined.

If either of the ordinances is declared valid by this Court then the object which the City of Louisville sought to accomplish in passing the two ordinances will have been accomplished.

Third: Both ordinances became laws early in 1909, and as the lower Court refused to require the Appellee to pay into Court the amounts collected by it in excess of the amounts it was entitled to collect under the rate ordinance (cause No. 761) or to give a bond to refund the amount so collected, it will result, unless this cause is advanced, that Appellee will have been permitted, if either ordinance is valid, to disregard the

rate ordinance for four or five years; will have been permitted to charge exorbitant and discriminatory rates to its subscribers in violation of law and of the rights of the Appellant and the subscribers to Appellee's service; the said subscribers being thereby left without a remedy for the wrong so perpetrated.

Fourth: As a further reason for the granting of this application, the attention of the Honorable Judges of this Court is respectfully called to Sections 7 and 8 of Rule 26 of this Court, and also to Sections 921 and 949 of the United States Compiled Statutes for the year 1901.

It is respectfully submitted that special and peculiar circumstances, such as are referred to in Section 7 of Rule 26, exist in the above styled cause.

It is further submitted that the two causes herein referred to involve the same question within the meaning of Section 8 of Rule 26.

Section 921 is as follows:

"When causes of a like nature or relative to the same question are pending before a court of the United States, or of any Territory, the court may make such orders and rules concerning proceedings therein as may be conformable to the usages of courts for avoiding unnecessary costs or delay in the administration of justice, and may consolidate said causes when it appears reasonable to do so."

Section 949 is as follows:

"When a State is a party, or the execution of the revenue laws of a State is enjoined or stayed, in any suit in a court of the United States, such State or the party claiming under the revenue laws of a State, the execution whereof is enjoined or stayed, shall be entitled, on showing sufficient reason, to have the cause heard at any time after it is docketed, in preference to any civil cause pending in such court between private parties."

It is submitted that the two above entitled causes now pending in this Court relate to the same question, viz: the regulation of Appellee's rates, and the prevention of discrimination, and for that reason come within the terms of Section 921 of the Compiled Statutes, and that the two causes should be consolidated in order that delay in the administration of justice may be prevented and unnecessary cost avoided.

It is submitted further that the Appellee is an arm of the State of Kentucky, and should be on the same footing as a State, and as such should come within the meaning of Section 949 of the Compiled Statutes.

CLAYTON B. BLAKEY,

Counsel for Appellant.

City of Louisville.

HUSTON QUIN,

Of Counsel.

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JAMES H. MCKENNEY,
CLERK

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1911.

No. 761.

**CITY OF LOUISVILLE, KENTUCKY,
APPELLANT,**

vs.

**CUMBERLAND TELEPHONE AND TELE-
GRAPH COMPANY, APPELLEE.**

**APPEAL FROM THE CIRCUIT COURT OF THE UNITED STATES
FOR THE WESTERN DISTRICT OF KENTUCKY.**

**ADDITIONAL SUGGESTIONS IN SUPPORT OF
MOTION TO ADVANCE.**

CLAYTON B. BLAKEY,
Counsel for Appellant, City of Louisville.

HUSTON QUIN,
Of Counsel.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1911.

No. 761.

CITY OF LOUISVILLE, KENTUCKY,
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vs.

CUMBERLAND TELEPHONE AND TELE-
GRAPH COMPANY, APPELLEE.

**ADDITIONAL SUGGESTIONS IN SUPPORT OF
MOTION TO ADVANCE.**

The motion as made is primarily to advance the case.

Appellee does *not* object to the motion to advance.

Appellee *does* object to this case (\neq 761) being consolidated with case \neq 197, pending in this court between the same parties.

The reasons for the consolidation of the two cases are shown in the printed motion heretofore filed, and we think those reasons are sound.

But the position urged by appellant is that this is a rate case; that it is of great public interest, and that unless the case is advanced all of the subscribers to a telephone exchange in a large city will, under the ruling of the lower court, be compelled to pay exorbitant rates for several years without a right of recovery should the rate ordinance be held valid by this court.

Respectfully submitted,

CLAYTON B. BLAKEY,

Counsel for Appellant.

HUSTON QUIN,

Of Counsel.

Office Supreme Court, U. S.
FILED.

OCT 9 1911

JAMES H. MCKENNEY

CLERK

Supreme Court of the United States

No. 761.

OCTOBER TERM, 1911.

City of Louisville, Kentucky, - - - - - *Appellant,*

VERSUS

Cumberland Telephone and Telegraph
Company - - - - - *Appellee.*

Appeal from the Circuit Court of the United States for the
Western District of Kentucky.

BRIEF FOR APPELLEE ON MOTION TO ADVANCE.

WM. L. GRANBERY,
ALEX P. HUMPHREY,

Counsel for Appellee.



Supreme Court of the United States

October Term, 1911.

No. 761.

CITY OF LOUISVILLE, *Appellant,*

VS. REPLY OF APPELLEE TO MOTION
 OF APPELLANT.

CUMBERLAND TELEPHONE AND TELEGRAPH
COMPANY, *Appellee,*

The appellee objects to the motion of the appellant to order a consolidation of this case with that of the City of Louisville, Appellant, v. Cumberland Telephone and Telegraph Company, Appellee, No. 197, or to any order hearing these two cases together.

It is true that the appellant and appellee in each case are the same, but beyond that there is no likeness between the two cases.

The Legislature of Kentucky granted a certain franchise to a company to whose rights the appellee has succeeded. This franchise was made dependent upon the assent to its operation by the City of Louisville. This assent was given, and thereupon the grantee of the franchise expended a very large sum of money in order to the employment of such franchise. The City of Louisville attempted to repeal this franchise. Thereupon the Cumberland Telephone and Telegraph Company, which, as above stated, had succeeded to the franchise, filed a bill in the Circuit Court of the United States for the

Western District of Kentucky, the sole object of which was to declare this ordinance void as impairing the obligation of the contract. This relief was granted and a decree entered perpetually enjoining the City from the enforcement of its repealing ordinance. The City has brought this case here and it is No. 197 on the docket of the present term.

After this effort to repeal absolutely the franchise the City of Louisville passed another ordinance, fixing the rates for service of the Cumberland Telephone and Telegraph Company. This company then filed another bill, setting out that these rates so fixed were confiscatory in their character and were therefore in violation of the Fourteenth Amendment of the Constitution of the United States. A very large volume of proof was taken upon the issues formed in this last case. The court below finding that the complainant (now appellee) was right in its contention and that the rates proposed to be enforced were confiscatory, perpetually enjoined the enforcement of this ordinance.

It is obvious from this statement that if these two cases are ordered to be consolidated or heard together, the argument in the one case would have no sort of relevancy to the argument in the other case.

The right of the City of Louisville absolutely to take away the franchise of the Cumberland Telephone and Telegraph Company is in no way illustrated by any discussion of the question as to whether the rates fixed by the City of Louisville in the second ordinance are or are not confiscatory in their character. And so the argument as to these rates—which is the question raised in

the second case—has no relevancy to the question as to whether the City had the right to take away absolutely the franchise of the Company.

For an orderly hearing of the matters in controversy it would seem to us that a course exactly contrary to that proposed should be pursued, and that the second case should not only not be heard with the first case but should not be heard until after the first case has been decided. If it be true that the City of Louisville had the right absolutely to take away from the Cumberland Telephone and Telegraph Company its franchise then necessarily the second case will fall under the weight of the decision in the first case.

It is difficult for us to conceive any reason for this court hearing a discussion upon the issues raised in the Rate case and assuming the burden of examining that record on its facts, until the court has determined, as it will in the first case, whether the Cumberland Telephone Company has any franchise at all.

We therefore submit that the cases should come up in their regular order.

Respectfully submitted,

WM. L. GRANBERY,
ALEX. P. HUMPHREY,

Counsel for Appellee. 